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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1938.

No. 312

JOHN M. TAYLOR, OSCAR A. KENNEDY and H. RUSSELL HASTINGS, as the Independent Committee for the Protection of the Holders of Preferred Stock of Deep Rock Oil Corporation, Debtor,

Petitioners,

vs.

STANDARD GAS AND ELECTRIC COMPANY; REORGANIZATION COMMITTEE OF DEEP ROCK OIL CORPORATION; H. N. GREIS, Trustee of Deep Rock Oil Corporation; and DEEP ROCK OIL CORPORATION,

Respondents.

BRIEF ON BEHALF OF THE MEMBERS OF THE REORGANIZATION COMMITTEE OF DEEP ROCK OIL CORPORATION, RESPONDENTS.

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Respondents.

BRIEF ON BEHALF OF THE MEMBERS OF THE REORGANIZATION COMMITTEE OF DEEP ROCK OIL CORPORATION, RESPONDENTS.

I.

OPINIONS OF COURTS BELOW

The District Court rendered no opinion. The opinion of the Circuit Court of Appeals for the Tenth Circuit is reported in 96 F. (2d) 693-710. (Record, Vol. I, pp. 477-505.)

II.

JURISDICTION

This Court granted a petition for certiorari to the Circuit Court of Appeals for the Tenth Circuit on October 10, 1938. The statutory provision under which the jurisdiction of the Court was invoked is Section 240 (a) of the Judicial Code as Amended (28 U.S.C.A., Sec. 347). The decree of the Circuit Court of Appeals was entered on April 27, 1938 (Vol. I, p. 505). A petition for rehearing was filed by petitioners on May 25, 1938 (Vol. I, pp. 507-526, 527). This petition was denied on June 6, 1938. (Vol. I, p. 527.) Petition for certiorari was filed August 30, 1938.

III.

INTRODUCTORY STATEMENT

The petitioners, a minority group of preferred stockholders of Deep Rock O' Corporation, debtor in a proceeding pending in the District Court of the United States for the Northern District of Oklahoma under Section 77B of the Bankruptcy Act as amended, seek the reversal by this Court of the order entered by the District Judge on February 3, 1937, and affirmed by the Circuit Court of Appeals for the Tenth Circuit which ended four years of effort by the District Court and the interested parties to effect a reorganization of the debtor's complicated financial affairs.

The order of the District Judge, entered in the exercise of his discretionary power, approved a compromise at approximately $5,000,000 of an unsecured claim for $9,342,000 plus interest, asserted by Standard Gas and Electric Company (hereinafter referred to as "Standard"), and confirmed an amended plan of reorganization based upon such compromise, which plan subordinated Standard to the other creditors. The compromise had been approved by counsel for the independent Trustee in Bankruptcy, by holders of more than 82% of the debtor's $10,000,000 note issue, and by the holders of more than 58% of the debtor's $5,000,000 preferred stock issue. The plan of reorganization had been accepted by the holders of the same percentages of notes and preferred stock, respectively, which had approved the compromise.

In order that this Court may fully understand the legal and practical problems which confronted the District Court, it is necessary to review the history of the case and the complexities involved in the conflicting rights asserted by the parties. As will appear in the following statement, petitioners' statement of facts is neither adequate nor accurate.

IV.

STATEMENT OF THE CASE

A. Historical Background of Deep Rock (Shaffer) and Institution of Hostile Proceedings.

In 1919 Standard, a public utility holding and investment company, sought a profitable investment in the oil business, an entirely unrelated industry. (Vol. II, pp. 4, 7.) Deep Rock Oil Corporation, the debtor, was then formed. It was not organized as a department of Standard. (Vol. II, p. 561.) It was organized in the spring of 1919 under the name of Shaffer Oil and Refining Company, and acquired its original properties from Mr. E. E. Smathers (Vol. II, p. 845) and Mr. C. B. Shaffer, who retained a substantial interest in the business (Vol. II, p. 10), pursuant to the provisions of a contract between Mr. Shaffer and H. M. Byllesby & Company. (Vol. II, pp. 635-643.) Mr. Shaffer received, in addition to cash, 60,000 shares of preferred stock of Shaffer Oil and Refining Company and 80,000 shares of common stock, and became the president of the company. (Vol. II, pp. 10, 18, 638.) Pursuant to the agreement, Mr. Shaffer was given charge "of the oil and gas interests in all their details" and the right to nominate one-half of the original board of directors. It was further provided that the voting control should be held for ten years by four voting trustees, two of whom should be named by Mr. Shaffer. (Vol. II, pp. 640-641, 561.) In 1921 an agreement was made with Mr. Shaffer pursuant to which he retired from the company. (Vol. II, pp. 11, 632-634.) In 1931, the debtor's name was changed to Deep Rock Oil Corporation. (Vol. II, p. 631.)

Deep Rock, upon its original incorporation, issued $15,000,000 of first mortgage bonds, 50,000 shares of preferred stock at $100 par value per share, and 500,000 shares of

common stock having a par value of $1 per share. (Vol. II, p. 11.) This capitalization was subsequently changed.

After 1928 the capitalization of Deep Rock consisted of $10,000,000 of publicly-owned 6% notes, $5,000,000 par value of publicly-owned preferred stock, and common stock substantially all of which was owned by Standard. In 1932 refunding and refinancing efforts by corporations with maturing obligations were virtually impossible of achievement. The debtor, Deep Rock Oil Corporation (herein referred to as "Deep Rock"), then conducted an oil business consisting of an integrated unit including producing properties, a refinery, pipe lines, tank cars, and retail distributing stations. (Vol. II, pp. 827, 828.) It was faced with the maturity on March 1, 1933 of the 6% notes in the aggregate principal amount of $10,000,000. These notes were held by thousands of individual owners residing throughout the United States. Deep Rock had an issue of preferred stock, which was also sold to and owned by the public as a security of Deep Rock and not of Standard, having an aggregate par value of $5,000,000, consisting of 50,000 shares of the par value of $100 each. More than 98% of the common stock of Deep Rock was owned by Standard. The $10,000,000 of Deep Rock notes had been sold to the public in 1928 by an underwriting syndicate consisting of H. M. Byllesby & Company (hereinafter called "Byllesby"), Federal Securities Corporation and Janney & Company. (Vol. II, p. 626.)

In 1932 Byllesby, with other interests, jointly controlled the management of Standard (Vol. II, pp. 412, 833), and of course Standard, through the exercise of power attendant upon the ownership of common stock, elected the board of directors of Deep Rock. The identity of the directors and officers of Byllesby and Standard, however, was terminated

in the fall of 1936. (Vol. II, p. 412.) The stock held theretofore by Byllesby, which enabled it jointly with other interests to control the management of Standard, was placed in a voting trust (where it still remains), the trustees of which are not officers of Byllesby. (Vol. II, p. 469.)

Deep Rock has always been operated as a corporation separate from Standard. It has paid its own officers and employes. (Vol. II, p. 703.) Petitioners failed to state that at no time has there been any commingling of the assets and properties of Standard and Deep Rock. (Vol. II, pp. 387, 561, 703.)

The business operation of Deep Rock in 1932, as had been the case for several years prior thereto, was under the direct control and supervision of John L. Gray, Vice-President and General Manager, L. B. Riddle, Vice-President-in-Charge-of-Production, and other officers situated at the Deep Rock offices in Tulsa, Oklahoma. (Vol. II, pp. 5, 21, 24, 32, 36, 193, 224, 386, 387, 390; master's report, Vol. I, p. 174.) Neither Gray nor Riddle had had any business affiliation with Standard or Byllesby except that Gray for one year was a Standard director. Both were employed at substantial salaries as officers and business managers of Deep Rock. (Vol. II, pp. 193, 224.) In their individual capacities they owned securities of Deep Rock. (Vol. II, pp. 66, 162.)

In 1932 Deep Rock contracted with Byllesby, for a consideration shown to be entirely reasonable (Vol. II, pp. 71, 398), to seek a voluntary agreement by the holders of Deep Rock notes to an extension of the maturity thereof for a period of four years from March 1, 1933, to March 1, 1937. As an inducement to such creditors to agree to the extension, the interest rate on the extended notes was increased from six to seven percent. The effort to procure a voluntary extension met with substantial success, and at the time

of the institution of the receivership proceeding holders more than 78% of Deep Rock notes had agreed there (Vol. II, pp. 173, 627, 628, 821.)

On February 28, 1933, John L. Gray and L. B. Riddl represented by Messrs. Ramsey, deMeules, Martin a Logan, of Tulsa, Oklahoma, filed in the District Court Tulsa County, Oklahoma, a hostile proceeding in equi against Deep Rock, Standard, Deep Rock Oil & Refini Company, and Oklahoma Gas & Electric Company; and that date E. H. Moore was appointed receiver of Deep Roc (Vol. II, p. 687.) Immediately thereafter the cause was r moved to the United States District Court for the Northe District of Oklahoma, and on March 2, 1933, the Unite States District Court appointed H. N. Greis and E. H Moore co-receivers of Deep Rock. (Vol. I, p. 23.)

The allegations of the bill of complaint filed by Gray and Riddle in the state court charged Standard with the domination and control of Deep Rock, alleged fraud in the exercise of such control, claimed the invalidity of the $9,342,000 unsecured claim asserted by Standard against Deep Rock, and urged liability of Standard to Deep Rock. (Vol. II, pp. 687, *et seq.*) Messrs. Ramsey, deMeules, Martin and Logan, who presented these charges, became counsel for the receivers, Greis and Moore, and were charged with the responsibility of asserting the demands against Standard and defending the estate in receivership against the $9,342,000 Standard claim. (Vol. II, pp. 290, 291.) Standard filed its claim in the Federal Court receivership proceeding (Vol. II, p. 266), and the receivers filed an answer and counterclaim thereto repeating the charges of liability and attacking the validity of the Standard claim. (Vol. II, p. 276.) Petitioners did not state that the issues surrounding the validity of the Standard claim against Deep Rock were thus presented for litigation and adjudication by hostile proceedings.

B. The Character of the Unsecured Claim of Standard Gas and Electric Company.

The claim of Standard against Deep Rock, which at the time of the institution of the original equity proceeding was the chief issue, then held and ever since has occupied the major attention of the court, the receivers and bankruptcy trustee, their counsel, and the parties in interest. The questions as to the validity of the Standard claim, the extent to which and manner by which it may be accorded participation in the reorganization of the financial affairs of Deep Rock have been recognized as the heart of the litigation.

Standard has at all times asserted its right to a claim for $9,342,000, with interest, on a parity with the $10,000,000 claim of the noteholders and of course senior to the rights of the preferred stockholders. The receivers, and later the trustee in bankruptcy, have urged in their pleadings that the claim is invalid in its entirety. (Vol. II, pp. 699-700.)

The claim arose on open account between Standard and Deep Rock and represents the balance shown due by the books of both corporations. The books and records of Deep Rock and Standard have always been kept separate and apart from each other. (Vol. II, p. 387.) Petitioners conspicuously failed to show that the $9,342,000 balance has accumulated since approximately April 1, 1928. In 1928 Standard was the owner of an unsecured note of Deep Rock in the amount of $4,250,000, and in addition Deep Rock was indebted to Standard on open account in the amount of $6,836,195.85, the aggregate of the two figures being $11,086,195.85. Standard also then owned, in addition to common stock of Deep Rock, 90,000 shares of 7% preferred stock. When the $10,000,000 issue of Deep Rock 6% notes was sold in 1928, Standard surrendered its claim for $11,-

086,195.85 (determined as of February 24, 1928) and its 90,000 shares of preferred stock for common stock. (Vol. I, p. 58; Vol. II, pp. 68, 129, 273, 274, 426, 701.) The uncontradicted testimony shows that, "At the conclusion of that transaction, Standard held nothing but the common stock, except that there was a small balance of a few thousand dollars on the open account which it was not possible to bring down to the last cent in the issuance of common stock." (Vol. II, p. 68.)

The claim consisted of items of many types, representing a variety of transactions. It included cash advances by Standard to Deep Rock, moneys expended by Standard on behalf of Deep Rock in payment of Deep Rock obligations to third parties, dividends on Deep Rock stock declared and payable to Standard, management and supervision fees, rental payments due under the terms of a lease to Deep Rock of properties owned by Deep Rock Oil & Refining Company (hereinafter referred to as the "Refining Company"), another subsidiary of Standard, and compound interest on these items at the rate of 7% computed on monthly averages, which brought the annual interest rate to approximately 7.27% per annum. (Vol. II, pp. 268-272, 435, 700.)

Among the perplexing factual and legal issues presented by the voluminous financial transactions involved in the claim was the controversy respecting the lease to Deep Rock of the Refining Company properties.

In 1922 and 1923, by the use of funds supplied by Standard and charged to Deep Rock, which ultimately aggregated in excess of $2,500,000 (Vol. II, pp. 389, 563), producing properties known as the Bradstreet Acreage were acquired and a cracking plant, which became an important part of the refinery operations, was built. The $650,000 purchase price of the Broadstreet Acreage was paid directly by

Standard to the extent of $500,000 and by the payment of Deep Rock notes in the amount of $150,000. (Vol. I, p. 178; Vol. II, p. 53.) Throughout the discussion of the Refining Company transactions petitioners do not refer to the fact that Standard advanced the money (Pet. Br. pp. 41-49), although emphasis is placed upon the purchase of and payment for the properties by Deep Rock. (Pet. Br. p. 43.) The legal title to these properties was placed in individual trustees, who in turn were charged by Deep Rock with the amounts so expended. Later, as the result of transactions reflected on the books of the three corporations involved, Standard became the owner of the entire capital stock of the Refining Company, and also the owner of the unsecured note of the Refining Company in the principal amount of $1,894,592.11. On October 1, 1925, Standard credited to Deep Rock on the open account the $2,500,000 expended as aforesaid. De p Rock retained the substantial profits ($1,619,398.88) realized from the previous operation of the properties (Vol. II, pp. 53, 102); and thereafter leased, at a large rental, from the Refining Company the Bradstreet Acreage and the cracking plant. (Vol. II, pp. 44-46, 48-54, 128, 132, 153, 154, 176, 177, 285 (receiver's counterclaim), 563, 702-3.)

Thereafter, the Refining Company would declare dividends payable to Standard equal to the rent due to the Refining Company from Deep Rock. In lieu of receiving payment of such dividends in cash Standard accepted Deep Rock's obligation to pay such accrued rent, thus increasing the open account. (Vol. II, pp. 76, 95, 132, 133, 153.) The validity of these transactions and the propriety of the rentals so included in the Standard claim have occupied an important part of the controversy.

During the period from 1928 to the date of receivership certain payments were made by Deep Rock to Standard

which were credited on the open account. (Vol. II, pp. 196-197.) Certain of such payments were applied by Standard as payment of the Refining Company rentals. (Vol. I, p. 63; Vol. II, pp. 122, 123.) All payments by Deep Rock however, never balanced the account and at all times were much less in amount than actual cash advances being currently made by Standard to or on behalf of Deep Rock. (Vol. I, pp. 61, *et seq.;* Vol. II, p. 559.) The history of the Standard claim shows, among other things, the aggregate advancement since 1919 by Standard to Deep Rock, or for its benefit to third parties, of cash in the total amount of $31,000,000, and the receipt by Standard from Deep Rock in cash of only $19,000,000. (Interveners' Ex. 18, Vol. III, p. 147; Ex. A, Brief of Standard.)

C. The Attack Upon the Standard Claim.

The receivers, and later H. N. Greis, the trustee of Deep Rock, and their counsel, Messrs. Ramsey, deMeules, Martin and Logan, exhaustively investigated the Standard claim and litigated the issues involved. (Vol. I, p. 108, Vol. II, pp. 1-376.) The court, by formal order, directed the receivers to investigate the claim and assert any liabilities that might exist against Standard, and the trustee has testified that he gave complete authority to counsel to act. (Vol. II, pp. 290, 291, 521, 522.) The matter was referred to the Hon. Preston C. West, as special master, and extensive hearings were conducted throughout 1934 and the early months of 1935. (Vol. I, p. 24.) Witnesses were examined in Chicago and at Tulsa, additional elaborate interrogatories were presented to various officers and agents of both Standard and Deep Rock, and the answers filed of record; an extensive stipulation accompanied by twenty-eight exhibits was prepared and filed by counsel for the trustee and Standard. (Vol. II, pp. 242, *et seq.*) The record shows by the testimony of Mr. Ramsey (leading counsel for the trustee) that the Standard witnesses evidenced "no disposition to sup-

press anything." (Vol. II, p. 391.) Mr. Ramsey prepared a lengthy brief on the legal issues involved, including the applicability of the so-called "instrumentality rule" pursuant to which it was urged by the trustee that the claim should be denied in its entirety. (Vol. II, pp. 379, 381, 388.)

D. The Organization and Personnel of the Reorganization Committee.

Upon institution of the receivership proceeding in February of 1933, Byllesby was then engaged in an effort to procure a voluntary extension agreement from the holders of Deep Rock notes (Vol. II, p. 398). It was then determined by the officers of Byllesby to form a reorganization committee, to be composed of men "so far as we possibly could, who had no interest or association with H. M. Byllesby & Company or Standard," together with representatives of the investment banking houses or their successors who originally sold and distributed the notes and preferred stock. (Vol. II, pp. 423, 424.)

As a result of this decision, the reorganization committee was formed. It consisted, in addition to Mr. John J. Shinners, a vice-president of Byllesby, who was elected chairman, of the late Col. Grayson M.-P. Murphy, a banker and financier of New York City, who had had no connection with Byllesby or Standard in connection with the distribution of the securities of either Deep Rock or Standard; Mr. Albert J. Robertson, a vice-president of the Iowa-DesMoines National Bank & Trust Company; Mr. John H. Mason, formerly chairman of the Main Line Trust Company, of Ardmore, Pennsylvania; Mr. Robert F. Holden, then a vice-president of Janney & Company, of Philadelphia; and Mr. Newton P. Frye, the president of Central Republic Company, of Chicago, who was formerly a vice-president of Federal Securities Corporation. (Vol. II, pp. 833-835.) No one of the

members of the reorganization committee owns any of t Deep Rock securities. (Vol. II, p. 470.) These facts we not stated by petitioners.

The record reveals that the holders of notes and preferre stock of Deep Rock were repeatedly advised as to all con nections and associations, if any, of each member of the reorganization committee with Standard, Byllesby or Deep Rock. (Vol. II, pp. 833-835, 730.)

E. History of the Activities of the Reorganization Committee.

Upon its formation, the committee made no effort to solicit a following among the securityholders by asking for deposits of notes and preferred stock under the terms of the conventional "blind" deposit agreement. (Vol. II, p. 424.) It at once proceeded with an independent and careful study of the relationship and transactions between Deep Rock, Standard, Byllesby and the Refining Company. With the aid of its counsel and accountants, the committee reviewed the history of the Standard claim, the effect of the settlement of that claim in 1928, the basis and legitimacy of the items constituting the claim filed for $9,342,000 and the legal principles and issues involved. (Vol. II, pp. 425, 433, 434, 437, 439, 440, 819-820, 824.) In 1934 counsel for the reorganization committee advised the committee members that Standard would have to be considered in any reorganization plan, since in their opinion Standard could justify and support a claim in the approximate amount of $7,300,000.[1] (Vol. II,

[1]This independent conclusion reached by the committee, through its investigation aided by counsel and accountants, closely corresponds with the view later reached and subsequently announced by counsel for the trustee (Mr. Ramsey) in the communication addressed by the trustee to the securityholders in the summer of 1935 (see Record, Vol. II, pp. 699, *et seq.*) where it was stated: "... making a total balance in favor of Standard on its claim of $7,604,857.28, on a parity with noteholders and other creditors of Deep Rock, unless Deep Rock is adjudged a department of the Standard." (Vol. II, p. 703.)

pp. 440, 824.) The reorganization committee became conversant with the care and ability with which the receivers and their counsel were attacking the Standard claim (Vol. II, pp. 440, 448), and withheld all action in the hope that an end to the litigation might soon arrive and a plan of reorganization then be formulated on the basis of the adjudication of the claim. (Vol. II, pp. 440, 441.)

Not until the summer of 1934, more than eighteen months after the receivership proceeding had been instituted, did the reorganization committee conclude that the interests of the creditors and preferred stockholders of Deep Rock required that some progress be made in the presentation to and consideration by securityholders of a reorganization plan. (Vol. II, pp. 424, 564, 824, 825.)

Early in the summer of 1934, a voluntary petition under Section 77B of the Bankruptcy Act was filed by Deep Rock and approved by the District Judge. (Vol. I, p. 25.) Mr. Greis, one of the receivers in equity, was appointed sole trustee in bankruptcy, and the counsel for the receivers became counsel for Mr. Greis as trustee. (Vol. I, pp. 47 *et seq.*, 67 *et seq.*) The reference of the Standard claim controversy to Mr. West, as special master, theretofore made in the receivership proceeding, was renewed in the bankruptcy cause and the testimony and record taken before the special master were incorporated as a part of the bankruptcy proceeding. (Vol. I, p. 24.)

In fulfillment of the purpose of Section 77B to promote economy and expedition, and in response to the growing demand of securityholders that steps be taken to conclude the pending proceeding, the reorganization committee, in August of 1934, intervened in the 77B proceeding and filed a deposit agreement with the District Judge, together with a plan of reorganization. At the request of the committee, a hearing was held, duly noticed to all creditors and secur-

ityholders of the debtor, at which hearing the court approved as fair the terms and conditions of the deposit agreement pursuant to which the reorganization committee desired to solicit deposits of notes and preferred stock to evidence acceptance by such depositers of the terms of the original reorganization plan then filed. (Vol. I, pp. 68-79, 83-88.) The deposit agreement was thus submitted to the District Judge under the provisions of Section 3(a)(10) of the Securities Act of 1933, as amended, and in conformity with Section 77B, which gives to the District Judge broad power and control of committee authorizations. (Vol. I, pp. 78-79.) By order entered August 20, 1934, the District Judge not only held the deposit agreement to be fair, but also authorized the committee to solicit deposits of Deep Rock notes and preferred stock in acceptance of the original plan of reorganization. (Vol. I, pp. 83-88.)

The original reorganization plan had been prepared by the committee (Vol. I, p. 72), and in August of 1934 was formally proposed under the provisions of Section 77B by Deep Rock, as debtor. (Vol. I, pp. 79, 82.)

In view of the opinion of the reorganization committee that Standard could support its claim in a substantial manner, the claim was allotted a position in the plan. It was recognized, however, by the committee in its announcement of the plan that unless the Standard claim were allowed for at least $5,000,000 (of which a substantial amount would be held to rank on a parity with the Deep Rock notes) the plan would not meet the tests of fairness and would require modification. (Vol. II, p. 824.) The plan itself specifically provided that whatever might be the determination of the court as to the validity, extent and rank of the Standard claim, all noteholders who had theretofore deposited with the committee would be given an opportunity to withdraw, without expense, in the light of such adjudication. (Vol. II, pp. 825, 843.)

The estimate made by the office of the trustee as to the value of Deep Rock's properties when receivers were appointed was $12,000,000. (Vol. II, pp. 241, 378.) It was obvious that if Standard was allowed a claim of $5,000,000, that claim, plus the $10,000,000 (exclusive of interest) owed to the holders of notes, fixed the obligations due creditors in an amount substantially in excess of the estimated property values, with the result that the preferred stockholders of Deep Rock would not be entitled, as a matter of legal right, to participation in the securities of the reorganized company. The original plan, however, provided that the noteholders would receive, dollar for dollar, new 6% income debentures and 15% of the common stock of the new company; Standard, as claimant, would receive new preferred stock having an aggregate liquidating value of $2,500,000, and approximately 75% of the new common stock; and the preferred stockholders would receive 10% of the new common stock. (See chart, Vol. II, p. 823.) No participation has ever been allotted to Standard or others as the owners of Deep Rock common stock.

The promulgation of the original plan of reorganization in August of 1934, together with the deposit agreement dated as of August 9, 1934, was accompanied by extensive information and data assembled by the reorganization committee to assist the securityholders in determining whether or not to accept the plan. This is evidenced by the historical material included in the appendices to the committee's explanatory letter, which shows in detail the accounting practices of Deep Rock in the past as to the amortization, depreciation and retirement of properties, the past record of earnings of the properties, the record of losses on dry wells, and the estimated amount of depletion and depreciation to be computed under the terms of the plan in the determination of net income available for the payment of interest on the new income debentures. (Vol. II, pp. 819-841.)

On February 22, 1935, six months after the submission of the original plan, Messrs. John M. Taylor and William H. Taylor, who were then the owners of 550 shares of preferred stock of Deep Rock, intervened in the proceeding. (Vol. I, pp. 99-102.)

Large numbers of noteholders and preferred stockholders of Deep Rock had then accepted the original plan of reorganization and had deposited their securities with the reorganization committee. (Vol. II, p. 399.) There soon began the insistent demand by such depositors, which has since persisted, that results be accomplished, that the legal proceedings be terminated, and that the reorganization be completed. (Vol. II, p. 396.)

From August of 1934 through the autumn of that year and into the winter of 1934 and 1935 an adjudication of the Standard claim was awaited. (Vol. II, pp. 440-441.) In January of 1935 counsel for the trustee had not completed proofs before the special master.

Under the circumstances it seemed to be the obvious responsibility and duty of the reorganization committee to endeavor by all proper means to terminate the controversy fairly, to avoid the succession of appeals that would be taken therein by the trustee or Standard whatever the result in the District Court (Vol. I, p. 199), and to attempt to limit the large and ever-increasing drain upon the resources of the debtor to finance the conduct of the litigation. Their duty, in the light of the committee's opinion as to the validity of a substantial part of the claim, was to attempt to bring the conflicting parties together on a compromise. (Vol. II, pp. 396, 397, 441, 449, 704.)

F. History of the Compromise of the Standard Claim.

The First Offer of Compromise.

It was not, however, until after the first of February, 1935 that Mr. Shinners, the chairman of the reorganization committee (Vol. I, p. 188) in the fulfillment of its responsibility to the large number of the holders of securities deposited with it (77% of notes, 64% of preferred stock; Vol. II, p. 399), called upon the counsel for the trustee (Vol. II, p. 388), who had exhaustively studied and briefed the questions at issue (Vol. II, pp. 388, 561), and inquired whether or not "there was any basis at all on which an adjudication or compromise of the Standard claim could be effected." (Vol. II, p. 397.) Mr. Ramsey, who was personally reluctant to discuss settlement (Vol. II, p. 392), refused to consider the possibilities until after the proofs were closed, which event occurred shortly thereafter. (Vol. II, p. 398.)

Mr. Shinners, acting as "mediator" or "messenger boy", then proceeded with his efforts to induce Standard and its counsel, Mr. Gibson, and Mr. Greis and his counsel, Mr. Ramsey, to come to an agreement for submission to the court. (Vol. I, p. 188; Vol. II, pp. 441, 451.) These negotiations took some weeks and involved several trips to Tulsa by Mr. Shinners. (Vol. I, p. 188; Vol. II, pp. 397, 441-442.)

Counsel for the trustee conceded the debatable nature of his contention that the instrumentality rule was applicable. (Vol. II, pp. 379-380, 385, 388.) The negotiations resulted, on March 8, 1935, in an offer of compromise addressed by Standard to the trustee (Vol. I, p. 105), which was accepted by the trustee upon recommendation of his counsel. (Petitioners' Brief, p. 9; Vol. I, pp. 102-105.) This offer of compromise provided for the allowance of the claim of

Standard in the aggregate amount of approximately $5,000,000, of which approximately $3,500,000 would rank on a parity with the notes of Deep Rock. *The $5,000,000 consisted of moneys actually advanced by Standard in cash to Deep Rock or in payment of Deep Rock obligations to third parties who were in no way connected with Standard or Byllesby and a portion of the amounts actually expended by Standard in the purchase and development of the properties of the Refining Company, with interest.* (Vol. II, pp. 451, 559-560.) The offer further provided for the conveyance to Deep Rock of the Refining Company properties free from any claim by Standard. (Vol. I, p. 106.)

This offer of compromise by Standard, after its acceptance by the trustee, was submitted to the District Judge by a formal petition of the trustee. The petition stated that the trustee had given careful consideration to the offer, and, due to the numerous questions presented by the controversy, he believed it to be in the best interests of the estate to accept the compromise. The District Judge referred the question of the approval of the compromise to the special master who had heard the proofs on the claim. (Vol. I, pp. 102, 107.)

The Messrs. Taylor appeared by counsel at the hearing held in March of 1935 before the special master for the purpose of considering the compromise, and raised by oral and written argument all of the contentions formerly advanced by Mr. Ramsey in his attack upon the Standard claim, including the contention that the instrumentality rule required the court to recognize that Deep Rock was a mere department or instrumentality of Standard, and that Standard's claim should therefore be denied in its entirety. (Vol. I, pp. 148-160.) These considerations were well known to the master since he had heard at length all of the evidence upon the Standard claim. (Vol. I, pp.

164-188.) Evidence was heard and witnesses interrogated by the attorney representing the Taylors at this hearing in March of 1935. (Vol. II, pp. 376-400.) After a lapse of six weeks, the master filed his report, which considered all of the elements, found that the compromise was for the best interest of the estate and all interested parties, and recommended strongly that it be approved. (Vol. I, pp. 164-202.) In effect, as later publicly stated by the trustee, the master's report recognized that the factual and legal issues were debatable. (Vol. II, p. 704.) The master has not filed a report upon the merits of the Standard claim. (Vol. II, p. 407.)

Thereafter two hearings were held before the District Judge on the master's report which recommended approval of the first compromise proposal, the first on June 3, 1935, and the second on September 23, 1935. (Vol. II, p. 400.) At each of these hearings counsel for the Taylors appeared and attacked the compromise.

On June 3, 1935, the Messrs. Taylor sought leave to solicit a following among the holders of preferred stock, to be evidenced by broad powers-of-attorney, authorizing the Messrs. Taylor "to vote for or against any proposal . . . which may be submitted with respect to any proposed reorganization. . . ." (Vol. I, pp. 217-231.) On August 12, 1935, they were permitted by order of court (Vol. I, p. 242) to circularize the securityholders recommending a concerted attack upon the compromise. This communication to the securityholders by the Taylors stated in part: "We cannot urge too strongly upon you that this situation is one that requires your immediate action for the protection of your investment." (Vol. II, p. 713.) It was accompanied by a statement signed by the trustee and prepared by his counsel. (Vol. II, pp. 698-706.) The statement written

by counsel for the trustee is a persuasive appraisal of the complicated nature of the proceedings and reveals the peculiar desirability of settlement of this particular controversy.

At the conclusion of the second hearing before the District Judge (September 23, 1935) on the original offer of compromise, the court announced his ruling, which denied approval of the compromise. (Vol. II, p. 411.) The petitioners and respondents have differed in their interpretation of the court's intention and purpose: Our opponents insist that the court was persuaded that the Standard claim was invalid in its entirety because of the instrumentality rule. They point to a portion of the court's remarks to support their view. (Vol. I, p. 5.) The court, however, stated, at least ten distinct times, his willingness to approve a fair plan of compromise, and then emphasized his desire for continued negotiations to compromise the Standard claim "on a plan of reorganization". (Vol. II, pp. 407-411.) The language of the District Judge quoted by petitioners (Pet. Br., p. 10) shows on its face that the court was primarily concerned with the plan of reorganization rather than the Standard claim.

The District Judge by thus earnestly requesting a new compromise, showed clearly that he felt the Standard claim presented a meritorious basis for adjustment. The court was primarily concerned with the original plan of reorganization which he considered as putting "these preferred stockholders out in the cold" (Vol. II, p. 410), since under the terms of that plan the court felt that they would merely receive "a little piece of paper called common stock that I wouldn't give one cent for." (Vol. II, p. 406.) It will be remembered that the original plan provided for the issuance to Standard of 25,000 shares of

new preferred stock, senior to the new common of which 10% was allotted to the preferred stockholders of the debtor. This senior position of Standard in the reorganized company met the express disapproval of the court. (Vol. II, p. 408.)

As will be recited hereafter in this statement, the District Judge subsequently approved a new offer of compromise of the Standard claim which was made in connection with an amended plan of reorganization under the terms of which the participation in the new common stock given the preferred stockholders was doubled and no new preferred stock was allotted to Standard.

The New (Second) Offer of Compromise.

The effort of the parties to amend the plan of reorganization and to negotiate a new compromise of the Standard claim presented further difficulties. On September 27, 1935, the District Court of the United States for the District of Delaware acquired jurisdiction over Standard in a proceeding under Section 77B. (Vol. I, p. 297.) The affairs of Standard then became subject to the control of the District Court of Delaware, and all further business arrangements with Standard required the approval of that court.

After renewed efforts, the reorganization committee informally reported to the District Judge, in the presence of counsel for the trustee, Standard and petitioners, the negotiation of a new offer of compromise and the preparation of an amended plan. The District Judge requested the opinion of an informal committee of counsel consisting of Mr. Ramsey, representing the trustee, Mr. Gibson, representing Standard, and Mr. Milsten, Tulsa counsel for the independent objecting stockholders group.

A divided report was filed, Messrs. Ramsey and Gibson favoring the new compromise and plan, Mr. Milsten opposing. (Vol. I, pp. 247-254.) Upon the receipt of the report on February 17, 1936, the District Judge entered an order directing the reorganization committee, within forty-five days (unless extended), to submit an amended plan of reorganization "and as a basis thereof, a new offer by Standard under the authority of the Delaware court for the compromise . . . of all its claims against the debtor." (Vol. I, p. 246.)

It then became necessary, in view of the difficulties presented by Standard's 77B proceeding in Delaware (Vol. II, p. 461) to extend the time for presenting the amended plan and new offer of compromise, which was done by court orders. (Vol. I, pp. 255, 256, 257, 258, 276.) On November 2, 1936, the Federal Judge of the District Court of Delaware finally entered an order upon the petition of Standard (Vol. I, pp. 259-275) authorizing Standard to make the new offer of compromise and to accept the amended plan. (Vol. I, p. 298.) Immediately and on November 9, 1936, Deep Rock as debtor, with the approval of the District Judge, made amendments to the plan originally proposed in August of 1934 (Vol. I, pp. 284-294); Standard presented its new offer of compromise (Vol. I, pp. 296-300); and the reorganization committee, upon petition (Vol. I, p. 276), was directed and authorized to submit the amended plan and the new offer of compromise to the securityholders of Deep Rock. (Vol. I, pp. 288-294.) The court, in authorizing the reorganization committee to distribute to the securityholders the amended plan of reorganization and the new offer of compromise, directed the committee to advise those holders of notes and preferred stock who had theretofore accepted the original plan, that they were entitled to withdraw their securities without ex-

pense on or before December 5, 1936, failing which they would be deemed to have accepted the amended plan and to have approved the new offer of compromise. (Vol. I, p. 291.) This notice was duly given, although not mentioned by petitioners. (Vol. II, p. 721; Vol. I, p. 355.)

On November 16, 1936, the petitioners urged all depositors of preferred stock with the reorganization committee to withdraw and to direct the Independent Preferred Stockholders' Committee to act as their representatives in opposing the compromise and the amended plan. (Vol. I, pp. 323, 325-327; Vol. II, p. 682.)

The new offer of compromise of the Standard claim in certain respects resembled and in others substantially differed from the original offer. (Vol. II, pp. 731-734.) It provided for allowance of the claim at the same aggregate figure, to-wit, $5,000,000. Of the $5,000,000, instead of $3,500,000, $1,500,000 was to be allowed on a parity with the notes and the balance was subordinated to the notes but, of course, was to be allowed as a creditor's claim senior to the preferred stock. Under the new offer of compromise, as under the old, Standard was required to transfer to Deep Rock its entire interest in the properties of the Refining Company. The new offer (as did the original offer) eliminated from the amounts allowed in compromise all questionable items in the Standard claim which the trustee felt were subject to disallowance on their merits. (Vol. II, pp. 563, 704.) The $5,000,000 figure of the new offer of compromise, as was the case in the original offer, consisted solely of certain of the items which the trustee and his counsel felt could be established if any claim, as a matter of law, was allowable, being money actually advanced by Standard in cash to Deep Rock or in payment of Deep Rock obligations to third parties in no way connected with Standard or Byllesby,

and the amount actually expended by Standard in the purchase and development of the properties of the Refining Company, less the rentals accrued prior to the 1928 settlement for which Standard received common stock. Under the compromise, as aforesaid, Deep Rock acquired the Refining Company properties. (Vol. I, pp. 238-241; Vol. II, pp. 451, 559, 560, 702-704.)[2]

The new offer of compromise, however, unlike the original offer, was conditioned upon the confirmation by the District Court, on or before February 8, 1937, of a plan of reorganization acceptable to Standard and upon the affirmation of such confirmation on review if an appeal were taken therefrom. (Vol. II, p. 733.) Standard, in connection with the new offer of compromise, expressed its acceptance of the amended plan. (Vol. II, p. 734; Vol. I, p. 298.)

The compromise and the plan are, in substance, one. (Vol. II, pp. 465-467.) The compromise is expressly conditioned upon the confirmation of a plan acceptable to Standard; and Standard accepted the amended plan. In substance, Standard offered to compromise its claim and surrender the Refining Company assets in consideration of the participation allotted it under the terms of the amended plan.

The amended plan, as modified, provides for the issuance of $10,000,000 of new 6% income debentures to go to the present noteholders together with $1,200,000 (plus an amount equal to 6% per annum on the principal amount

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[2]The trustee and his counsel repeatedly admitted (Vol. II, pp. 704, 562, 563) that the compromise figure of $5,000,000 eliminated every debatable or so-called fraudulent item.

of notes from January 1, 1937, to the date of the new income debentures) in cash and 7% of the new common stock. (No noteholder has objected to the order finally confirming the amended plan as modified and approving the new compromise of the Standard claim.) In addition to the new income debentures only one class of securities is to be issued by the new company—that is common stock. This common stock is to be divided approximately 20% to the preferred stockholders of Deep Rock; approximately 7% to the noteholders; and 73% to Standard, as claimant. The amended plan gives the preferred stockholders one-fifth of the equity subject to a $10,000,000 debt, as compared with one-tenth of the equity subject to a $10,000,000 debt and 25,000 shares of preferred stock (liquidating value of $2,500,000), as provided in the original plan. Petitioners have arbitrarily sought (Pet. Br. p. 12) to allocate the participation of the noteholders under the confirmed plan of reorganization into payments made on account of principal and past due interest. This, of course, cannot theoretically or practically be done. The noteholders have a claim for $12,400,000, principal and interest, as of March 1, 1937. For this claim in its entirety the amended plan in substance grants to them the following:

> $10,000,000 of income debentures;
> 7% of the common stock; and
> $1,200,000 in cash, plus 6% from January 1, 1937, to the date of the new income debentures.

The amended plan also provides that Standard, allowed a creditor's position in the amount of $5,000,000 ($1,500,000 on a parity with the notes) upon approval of the compromise, is to subordinate its participation by the acceptance of common stock subject to the $10,000,000 of new in-

come debentures. (Vol. II, p. 720.) All of these elements are a part of the noteholders' participation, as are also the other provisions to be included in the indenture securing the new income debentures. It cannot be said that the 7% of common stock is given them for one-half of their past due interest; the various elements cannot be segregated. The participation of the noteholders in the new common stock to the extent of 7% is but a part of the whole. (For synopsis of amended plan see Vol. II, p. 723 (modifications, Vol. I, pp. 373-379); for comparison of original and amended plans, Vol. II, pp. 726-727, 412-417.)

G. Promulgation and Confirmation of Amended Plan.

Pursuant to the order of the District Judge, entered November 9, 1936 (Vol. I, p. 288), the reorganization committee notified the securityholders and creditors of the terms of the amended plan of reorganization and new offer of compromise. (Vol. I, pp. 25, 26, 29, 355.) The information thus made available to the depositors with the committee included the terms of the new offer of compromise; the distinction between the original and amended plan; the tentative appraisal of the trustee; and the changes, if any, in the business relationships of each member of the reorganization committee. The committee communication was accompanied by a complete report of the earnings and financial history of the enterprise since the announcement of the original plan in August of 1934. (Vol. II, pp. 719-757.) The depositors, both noteholders and preferred stockholders, were advised of their right to withdraw their securities from deposit with the reorganization committee, without expense, if they did not wish either to accept the amended plan of reorganization or to approve the new offer of compromise of the Standard claim. (Vol. II, p. 721.)

The Public Debate and the Following of the Taylor Committee.

The announcement of the amended plan and the accompanying offer of compromise was the occasion for a renewal by petitioners of their attack upon the amended plan, Standard, and the reorganization committee. (Vol. I, pp. 311-354.) The opportunity was presented on November 16, 1936, by the Taylor committee (petitioners) to the holders of preferred stock to withdraw from deposit with the reorganization committee and empower the objecting group to act for them in procuring better treatment. (Vol. I, p. 23.) The letter announcing this opportunity was accompanied by a power-of-attorney which stated that the individual preferred stockholder would "not be individually liable for any expense." (Vol. I, p. 327.) A sufficient following was not procured by the Taylor committee to reduce the acceptance by the preferred stockholders below the majority requirement of Section 77B. The Taylor committee intervened in lieu of the Messrs. Taylor at the time of the confirmation hearing on December 22, 1936. (Vol. I, p. 357.)

After the promulgation of the amended plan, and prior to the confirmation hearing, independent and prominent organizations engaged in the business of furnishing investment advice and financial statistics to a clientele situated throughout the country, voluntarily voiced their approval of the amended plan and compromise, and recommended acceptance by the securityholders of Deep Rock. Moody's Investors Service and Standard Statistics Company, nationally recognized investment analysts, expressed approval of the plan. (Vol. II, pp. 685, 418-419, 459.)

On February 3, 1937, when the amended plan, as modified, was finally confirmed and the new offer of compro-

mise was approved by the District Judge, the Taylor committee had procured general powers-of-attorney from the holders of 10,295 shares of preferred stock of Deep Rock. (Vol. I, pp. 33-34.) Petitioners have not stated that these 10,295 shares include 1,261 shares owned by John M. Taylor, the bulk of which was purchased *after* his original intervention in February, 1935, when he owned only 250 shares. (Vol. I, pp. 99-100.) The additional stock must have been acquired at depressed prices. Since it cannot be assumed that Mr. Taylor was satisfied with the amended plan, the additional shares must have been purchased as a speculation in this litigation which he has prosecuted through the employment of counsel upon a contingent fee basis. Counsel for petitioners failed to reply to repeated inquiries as to when the additional stock was bought and the prices paid. (Vol. II, pp. 584, 557-558, 418.)

On February 3, 1937, acceptances of the amended plan, as modified, were in hand from the holders of more than 82% of Deep Rock notes and from the holders of more than 58% of the preferred stock. (Vol. II, p. 579.) In addition, the reorganization committee was authorized to accept the amended plan and approve the compromise on behalf of the owners of 1,270 shares of preferred stock which had not been deposited with the committee. (Vol. II, p. 872.) The holders of the remaining balance of preferred stock (approximately 20%) neither deposited with the committee nor committed their representation to the objecting Taylor group, and were apparently satisfied to accept the plan if confirmed by the court.

The securityholders of Deep Rock were thoroughly informed, since they have been bombarded since the fall of 1935 with communications pro and con. (Vol. II, pp. 698-713, 717-865, 874, 685, 682, Vol. I, pp. 222, 323.) The District Judge laconically stated, "I don't think they lack any in-

formation." (Vol. II, p. 570.) Our literature has recommended the plan and the compromise; our opponents have attacked both the compromise and the plan; counsel for the trustee has explained the nature of the Standard claim.

The reorganization committee actually represented an informed majority group who favored both the amended plan, as modified, and the compromise of the Standard claim, when, on February 3, 1937, the committee asked confirmation on their behalf. (Vol. II, pp. 565-566, 573, 578, 579.)

The Confirmation Hearings.

Prior to the final approval of the plan, a confirmation hearing was held which commenced on December 12, 1936, and lasted for several days. (Vol. II, pp. 411-572.) Mr. Shinners, the chairman of the reorganization committee, and Mr. Greis, trustee of Deep Rock, were examined at length by counsel for petitioners. Proof was introduced respecting the value of the Deep Rock properties. This evidence, which is reviewed in detail hereafter (pp. 98 to 114 of this brief), consisted in part of an appraisal (Vol. I, pp. 358-361) by Mr. Greis, the highly qualified and independent trustee (Vol. II, pp. 452, 453, 514-531), the preparation of which involved months of time and the consideration in detail of the value, as a part of a going concern, of each item of debtor's property. (Vol. II, pp. 474, 507, 527, 529.) The testimony of Oscar F. Berend, an independent expert in the oil business, long engaged as an appraiser by leading members of the industry and prominent appraisal concerns, was presented. Mr. Berend carefully checked and approved the appraisal. (Vol. II, pp. 472-507.) The record also contains the testimony of W. R. Francisco, the treasurer and the chief auditor of the company, respecting the accounting provisions of the plan and the methods there stipulated for the

computation of depreciation, depletion and amortization. (Vol. II, pp. 533-537.) There was introduced the detailed study and analysis of the earnings of the enterprise both before and after receivership. (Vol. I, p. 401; Vol. II, pp. 526-529, 537, 474-484, 649-650, 738-743, 837-841.)

An elaborate inventory had been prepared and filed with the court on November 21, 1936, describing in detail each of the properties of the debtor. (Vol. I, p. 28.)

Monthly trustee's reports in cumulative form were on file covering the period from the inception of the court proceedings on March 1, 1933 to November 30, 1936, the last report being filed January 11, 1937, showing, *inter alia*, the gross income and expenses of operation. (Vol. I, pp. 396-409.) No mention is made by petitioners of this portion of the record. These earnings (Vol. I, p. 401; Vol. II, p. 738), after deducting charges for depreciation, depletion, amortization, etc., in the amounts reported by the reorganization committee to the securityholders (Vol. II, pp. 738-743) and established by uncontradicted testimony (Vol. II, pp. 461, 463, 533, 536 and 537), when capitalized at the rate of 10% (the rate advocated by petitioners' witness C. J. Smith—Vol. II, p. 554), would indicate fixed asset values substantially less than the $9,500,000 appearing in the trustee's appraisal of the physical properties. This result is demonstrated by a chart using 1936 earnings, which is attached as Exhibit A to this brief.

The record repeatedly refers to the recognized fact that the oil business is uncertain and highly speculative. (Vol. II, pp. 515, 516, 478, 507.)

The confirmation hearings also involved the consideration by the court of modifications of and objections to the amended plan suggested by the interested securityholders, including the holders of notes (Vol. I, pp. 300, 309; Vol. II,

pp. 414-417) and preferred stock. (Vol. I, pp. 328, 335, 347, 353, 420, 422.) Modifications were also suggested by the reorganization committee for the purpose of clarifying and strengthening certain accounting provisions of the plan. (Vol. I, p. 302; Vol. II, p. 414.) At the confirmation hearings various modifications were made by the District Judge. (Vol. I, pp. 373-379, 416-418; Vol. II, pp. 573-574.)

After the conclusion of the first confirmation hearing the court entered an order finding the amended plan to be lawfully proposed (Vol. I, p. 356) and took the matter of confirmation under advisement. (Vol. II, p. 572.) On December 22, 1936 (Vol. II, pp. 572-577), the court entered two conditional orders, one of which approved the compromise of the Standard claim for $5,000,000 (Vol. I, p. 393) (which compromise was expressly conditioned upon the final confirmation of a plan acceptable to Standard), and the other confirmed the amended plan as modified under the terms of the order. (Vol. I, pp. 363-390.) The confirmation order was conditioned upon the acceptance of the plan as modified by the holders of the requisite percentages of notes and preferred stock and by Standard, with the approval of the Delaware court. (Vol. II, p. 577; Vol. I, pp. 381-382, 419-420.)

Following the orders of December 22, 1936, a further publication of notice was made of the right to file additional objections to the plan as modified. (Vol. II, p. 578; Vol. I, pp. 25-26, 390-391.) The reorganization committee distributed to all securityholders of Deep Rock the terms and provisions of the modifications of the amended plan made by the order of December 22, 1936, and again notified the depositors that they could withdraw, without expense, if they did not wish to accept the amended plan as modified. (Vol. II, pp. 874-877.) On February 3, 1937 the record showed that in spite of a renewed attack by petitioners on

the amended plan as modified, the requisite percentages of noteholders and preferred stockholders again evidenced their approval of the compromise and the amended plan as modified by the order of December 22, 1936. (Vol. II, pp. 578, 579, 873, 874.) On February 3, 1937 a further hearing took place, at which additional objections and testimony were presented by counsel for the objecting preferred stockholders. (Vol. II, pp. 577-592.) The chairman of the reorganization committee was again subjected to further interrogation on the stand. Mr. Greis, the trustee, was further examined. The District Judge then, after the lapse of four years of time since he first took jurisdiction of the affairs of the debtor corporation, entered his final order confirming the amended plan as modified, and as a part thereof approved the compromise of the Standard claim. (Vol. I, p. 428.)

In the interval between the December 12, 1936 and February 3, 1937 hearings Standard, pursuant to the approval of the Delaware District Court, accepted the amended plan as modified by the order of December 22, 1936, and as further modified by a subsequent order entered on January 18, 1937 (Vol. I, pp. 413-419) dealing with the retention of jurisdiction by the court over the new company. (Vol. I, pp. 425-428; Vol. II, pp. 577-578.)

The Record Before the District Judge.

The District Judge, when, on December 22, 1936 and February 3, 1937, he entered the intermediary and final orders confirming the plan and approving the compromise, occupied, as shown above, a position of unprecedented familiarity with the issues. The record reveals his careful study of the situation. (Vol. II, pp. 406, 573.) He had exercised jurisdic-

tion over the affairs of the debtor corporation for a protracted period of time. The receivers and later the trustee in bankruptcy had conducted and managed, under his direct supervision and control, the business operations of the debtor for a period of four years. Mr. H. N. Greis, the competent and disinterested trustee in bankruptcy, who was also appointed by the District Judge as co-receiver with Mr. E. H. Moore upon the removal of the cause from the state to the federal court in February of 1933, has had vast experience in the oil business and is particularly familiar with the problems and speculative vagaries incident to the production of oil. (Vol. II, pp. 452, 453, 514-516.)

In the consideration of the compromise of the Standard claim the court had before it the record taken by the special master over a long period, including the voluminous documentary evidence and the testimony of many witnesses. (Vol. II, pp. 1-376.) The court stated that an additional audit report would not have been of assistance. (Vol. II, p. 437, 438.) The court had the benefit of the written and oral contentions and arguments presented on behalf of the objecting stockholders on repeated occasions, beginning with the consideration of the first offer of compromise of the Standard claim in March of 1935, and followed by arguments made and briefs filed in connection with the hearings in June and September of 1935 (Vol. II, pp. 400, 401), which contentions were renewed verbally and in writing in opposition to the amended plan in November, 1936 and upon the hearings on confirmation on December 12, 1936, December 2, 1936 and February 3, 1937.

The great majority of the securityholders approved the compromise. (Vol. II, p. 573.) Their disinterested representatives, counsel for the trustee, recommended its acceptance (Vol. II, pp. 561-564); and their selected attorneys-in-

fact, the members of the reorganization committee, solicited the approval of the court. (Vol. II, pp. 565-566.)[3]

In confirming the amended plan of reorganization as modified, the court was faced with the following facts: Deep Rock was indebted to the noteholders in the aggregate amount of $12,400,000 (including interest to March 1, 1937); Deep Rock was further indebted, under the compromise, to Standard in the amount of approximately $5,100,000. The aggregate of these debts ($17,500,000) was more than the full fair value of the debtor's assets, found by the court not to exceed $17,000,000. (Vol. I, pp. 371-372.) Since the debts exceeded the valuation, it was obvious that the plan of reorganization was fair to preferred stockholders who were allotted 20% of the common stock of the new company which would own the assets. The new common stock would be subject only to a $10,000,000 debt.

[3]Counsel for the reorganization committee, after the explicit recommendation of counsel for the trustee, stated to the court: "The committee is entirely satisfied, in view of the statement made by counsel for the trustee, to speak for 80% of the noteholders and 60% of the preferred stockholders in recommending to the court the acceptance of the compromise. I would not have taken the responsibility of telling this court that we thought that compromise should have been approved if counsel for the trustee was not willing to make the recommendation made. He has made it. We are confident that we have a right to rely on it, and speaking for these people, solicit the court to approve it." (Vol. II, pp. 565-566.)

V.

SUMMARY OF ARGUMENT.

Whether a contested claim in a bankruptcy proceeding should be compromised and, if so, at what figure and with what rights under a reorganization plan, is a matter of judgment and discretion. The concurrent opinion of the District Judge and the Circuit Court of Appeals will be accepted unless it is clearly wrong.

Since the record shows that the Standard claim presents a meritorious basis for settlement, the interests of the public holders of Deep Rock notes and preferred stock have been furthered by the compromise in connection with the confirmation of a plan of reorganization which subordinates the position of Standard to the new income debentures and which grants a substantial participation to the preferred stockholders. By such compromise and plan there is avoided the serious disadvantage to such securityholders which would follow an allowance to Standard of a substantial claim on a parity with the notes. The compromise of the Standard claim was approved by counsel for the trustee, by the holders of eighty-two per cent of the notes and by the holders of fifty-eight per cent of the preferred stock. Of the remaining preferred stockholders, approximately twenty per cent apparently acquiesced in the action taken by their failure to vote, while petitioners represent approximately twenty per cent. None of the noteholders has objected to the compromise or plan.

The compromise of the Standard claim and confirmation of the reorganization plan not only avoided jeopardy to the public securityholders, but it also avoided for the estate the delay and expense of protracted litigation.

The merit of the compromise is shown by a consideration of the compromise figure. It includes no amount for even debatable items, and excludes any allowance for management fees, compound interest, dividends, rental on the Refining Company properties, and all other controverted charges. The compromise figure allowed net amounts which Standard, since the 1928 settlement of the open account, advanced in cash to Deep Rock or in payment of Deep Rock obligations to third parties, plus approximately sixty per cent of the moneys expended by Standard in the acquisition and development of the Refining Company properties, which under the compromise are to be transferred to Deep Rock.

The wisdom and fairness of the compromise is not affected by the so-called "instrumentality rule". In the light of the precedents, the District Court could not predict the ultimate decision of the courts in respect to such rule and its applicability in this case. A final determination that the rule was inapplicable would result in serious consequences to the holders of Deep Rock notes and preferred stock.

The instrumentality rule has never been successfully invoked by a subsidiary's preferred stockholders to defeat a valid claim of a parent corporation. The instrumentality rule is primarily designed to protect creditors of a grossly undercapitalized subsidiary transacting an important department of the parent's business. Such facts do not appear in the instant case.

The lower courts are fundamentally supported by the fact that the enforcement of the instrumentality rule in this case would unjustly enrich the preferred stockholders of Deep Rock at the expense of Standard and its security-holders. The instrumentality rule, like all other principles of equity, has never been permitted to produce an inequitable and punitive result.

The finding of the District Court, as affirmed by the Circuit Court of Appeals, as to the value of the debtor's assets is a finding of fact which is binding upon petitioners under the express provisions of the Bankruptcy Act as construed and enforced by this Court. This finding is based upon and is clearly supported by the evidence, including the appraisal by the qualified and independent trustee (which was confirmed by a thoroughly qualified expert) and by the full record made of the earnings of the enterprise and analysis thereof.

Since the debt owed to the holders of Deep Rock notes ($12,400,000 as of March 1, 1937) plus the compromise figure of the Standard claim ($5,100,000) exceeded the value of the assets ($17,000,000), the plan of reorganization which grants to the preferred stockholders twenty per cent of the equity of the reorganized company, subject only to an issue of income debentures aggregating $10,000,000, is obviously fair and equitable.

The reorganization committee has throughout acted in the interests of the holders of Deep Rock notes and preferred stock. The securityholders have been free agents, fully advised as to the material facts and their rights and given repeated opportunities, unaccompanied by financial burden, to withdraw their approval and acceptance of the compromise and plan. The record demonstrates that the reorganization committee has acted only with the approval of the court, and that its conduct has been fair and honorable. The general charges of wrongdoing leveled at reorganization committees cannot create issues which do not exist in this case.

VI.

ARGUMENT.

A. The District Judge, in approving a compromise of a claim against the debtor's estate, exercised a broad discretionary power, and the judgment of approval should not be reversed in the absence of a persuasive showing of gross and arbitrary abuse of such discretion.

The authorities are unanimous in holding that a District Judge, in the exercise of jurisdiction over the affairs of a corporation, either in receivership or bankruptcy, has the discretionary power to approve the settlement and compromise of claims against the estate. (Secs. 27, 77B (a) of the Bankruptcy Act; 11 U. S. C. A. Secs. 50, 207 (a).) The power has been frequently exercised in proceedings under Section 77B. *In re Prudence Co.*, 98 F. (2d) 559 (C. C. A. 2, 1938); *In re McCrory Stores Corporation*, 14 F. Supp. 739 (D. C. S. D. N. Y. 1935); *In re Burns Brothers*, 14 F. Supp. 910 (D. C. S. D. N. Y. 1936).

The existence of this power cannot be denied and is conceded by petitioners. (Pet. Br. p. 76.) Therefore, the only question presented here is whether in exercising his power the District Judge *abused his discretion.* All of the cases, including the action of the Circuit Court of Appeals in this case, are in harmony on this principle. Courts of review are uniformly reluctant to intrude upon the discretionary powers of the trial judge who has seen and heard the witnesses, and is thus best qualified to appraise the conflicting contentions. This principle was applied in approving compromises in *In re Riggi Brothers Co.*, 42 F. (2d) 174 (C. C. A. 2, 1930); *Pullman Couch Co.* v. *Eshelman*, 1 F. (2d) 885 (C. C. A. 4, 1924); and *In re Orinoco*

Corp., 269 Fed. 344 (C. C. A. 6, 1920), in each of which this Court refused certiorari (282 U. S. 881; 266 U. S. 631; 256 U. S. 694).

That the trial judge has the right and, indeed, the duty to settle comparable litigation has been stated by Circuit Judge Evans in the recent case of *In re Van Camp Products Company*, 95 F. (2d) 206, 208, (C. C. A. 7, 1938), cert. den. 59 S. Ct. 65 (1938), as follows:

> "... A breach of the parent company's obligation has, we think, caused counsel for appellants to overlook the unquestionable right (and we think the clear duty) of the court to settle sharply litigated questions in the interest of creditors and stockholders, although the exposure of those responsible for the unconscionable financing be not publicly made."

See also:

In re Prudence Co., 98 F. (2d) 559 (C. C. A. 2, 1938);

West v. *Radio-Keith-Orpheum*, 68 F. (2d) 869 (C. C. A. 2, 1934);

Drexel v. *Loomis*, 35 F. (2d) 800 (C. C. A. 8, 1929);

American District Steam Co. v. *Waltermire*, 231 Fed. 412 (C. C. A. 6, 1916);

In re National Artificial Silk Co., 272 Fed. 938 (C. C. A. 6, 1921);

Gordon v. *Hartford Sterling Co.*, 319 Pa. St. 174, 179 Atl. 234 (1935);

2 Remington on Bankruptcy, Sec. 1147 (Supp.);

Gilbert's Collier on Bankruptcy (3d Ed.), p. 567.

The Applicability of Section 27 of the Bankruptcy Act (11 U. S. C. A. 50).

Petitioners have suggested (Pet. Br. p. 80) that the District Court had no power to approve any compromise

of the Standard claim which was not submitted formally by the trustee under the permissive provisions of Section 27 which reads:

> "The trustee may with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate."

The first compromise proposal was formally submitted to the District Court and recommended by the petition of the trustee in exact compliance with Section 27 and General Order 33. (Vol. I, pp. 102-105.) In connection with this first proposal, the trustee also addressed a formal communication, with leave of court, to the securityholders outlining the basis upon which the trustee concluded that the compromise was to the best interests of the estate. (Vol. II, pp. 698-706.)

Since the first and second proposals of compromise contemplate settlement in an identical amount, it would seem that even in the most technical sense the presentation of the first compromise by the trustee in accordance with the supposed requirements of Section 27 of the statute would constitute a sufficient presentation of a compromise for the identical amount at a later date.

The statute does not pretend to be mandatory; it is permissive only. It certainly cannot be suggested, and no authorities are cited which even imply that a District Court in bankruptcy cannot on its own motion approve a compromise offered by a claimant and direct its acceptance by the trustee. *Pullman Couch Co.* v. *Eshelman,* 1 F. (2d) 885, 887 (C. C. A. 4, 1924), cert. den. 266 U. S. 631.

The second proposal of compromise was filed on the express order of the court (Vol. I, p. 246), and was formally approved by the trustee through counsel in a cate-

orical statement recommending approval by the Dis-
ict Court. (Vol. II, pp. 561-564.)

he District Judge Was Not Barred from Approving the Compromise of the Standard Claim under the Doctrine of Res Judicata.

We are required to comment briefly on the extraordinary aim that the District Judge, in the September, 1935 hear-g (when the first compromise of the Standard claim was enied approval) either finally adjudicated that claim on s merits or precluded any subsequent compromise. It is ardly necessary to observe that the merits of the claim ere not adjudicated. At the conclusion of the hearing the istrict Judge said:

> ". . . I would like to see you compromise. I don't believe you have offered compromise enough. . . . If you cannot compromise, we want to get together and finally dispose of the claim on its merits." (Vol. II, pp. 407-408, 411.)

ll counsel clearly understood that the District Judge in isapproving the first offer of compromise did not adjudi-ate the claim on its merits. Indeed, counsel for petition-rs, on November 2, 1935, filed a petition affirmatively lleging that it was desirable that a hearing on the merits f the claim be held, based on all of the testimony sub-itted in the cause "and on such additional evidence" as ie court might permit or direct. (Vol. I, pp. 245-246.)

Even if the District Judge had disallowed the claim com-letely he still had express authority under the terms of the ankruptcy Act itself to reconsider such action at any time efore the closing of the estate. Section 2 (2), 11 U. S. . A. Sec. 11 (2); *In re Hamilton Automobile Co.*, 209 Fed. 96, 599 (C. C. A. 7, 1913); 2 *Remington on Bankruptcy* 3d Ed., 1923) Sec. 967.

The denial by a district judge of a compromise in 1935, the approval of which would have required the confirmation of the original plan of reorganization, does not mean that the court thereby lost the power later to approve a compromise in connection with a substantially different plan which improved and increased the participation of the preferred stockholders. Petitioners' argument denies the fundamental power of the court.

B. The record clearly shows that in approving the compromise of the Standard claim and in confirming the plan of reorganization the District Judge acted for the best interests of the estate and did not abuse his discretion.

1. The Standard Claim Presented a Substantial Basis for Compromise.

We desire at the outset to disclaim any reluctance to consider the merits of the Standard claim, as charged by petitioners. It is necessary to remember, however, that the claim has never been adjudicated upon its merits (Vol. II pp. 407, 408; Pet. Br. pp. 8, 11), and that the case is not here to review such an adjudication. As stated by the Circuit Court of Appeals, it is unfair to approach the review of the orders of the District Court which simply approved a compromise, by asking that the Standard claim now be adjudicated on the merits. The Circuit Court of Appeals said:

> "The Independent Committee in effect asks us to adjudicate the merits of the Standard claim, and then in the light of that adjudication consider retrospectively the action of the court in approving the compromise. In seeking that approach the Independent Committee takes no risk. If we should decide adversely to the claim on the merits, then they ask us to dis-

approve the compromise. If we should decide in favor of the claim on the merits, they are insulated against injury by the compromise agreement. The unfairness of such an approach is manifest. Clearly, whether Standard was entitled to the allowance of its claim on the merits is not the issue here presented. That issue was never passed on by the Special Master or the court. The real issue is whether the plan meets the requirements of Section 77B of the Bankruptcy Act (11 U.S. C.A., Sec. 207 (b)(e)(f)) and is fair and equitable, and whether the court abused its discretion in approving the offer of compromise." (96 F. (2d) 693, 703; Vol. I, pp. 491-492.)

It is, of course, material and necessary to determine whether the issues of fact and law presented by the Standard claim were reasonably debatable and, in the language of the Circuit Court of Appeals, "whether the claim was so clearly invalid as to afford no substantial basis for a compromise." (96 F. (2d) 693, 703; Vol. I, p. 492.) But we do submit that if the claim were "clearly invalid" it is inconceivable that the trustee, his counsel, the special master, District Judge Kennamer, and Circuit Judges Phillips and Williams would all have approved its compromise for $5,000,000.

If the Standard claim presents a substantial and meritorious basis for settlement, the results achieved by the compromise of the claim in connection with the confirmation of the reorganization plan are decidedly in the interests of the holders of the Deep Rock notes and preferred stock. By such compromise and plan there is avoided for the noteholders and preferred stockholders the serious risk of an allowance to Standard of a substantial claim on a parity with the notes and the resultant adverse changes in the reorganization plan which such an allowance would require. We shall first consider the items which made up the $5,000,000 compromise figure and demonstrate their meritorious character.

The Standard claim as filed asserted an obligation of Deep Rock for approximately $9,342,000, plus interest, on a parity with the $10,000,000 claim of the noteholders and, of course, senior to the rights of the Deep Rock preferred stockholders. While the open account between Standard and Deep Rock began in 1919, the Court will remember that in 1928 a settlement was made of that account. The claim itself (Vol. I, pp. 58-60) is based solely on items accruing since the account was balanced in 1928 and not, as stated by petitioners, on the transactions which run back to 1919. (Pet. Br. p. 6.)

At the time of the 1928 settlement Standard was the owner of an unsecured note of Deep Rock in the amount of $4,250,000, and in addition Deep Rock was indebted to Standard on open account in the amount of $6,836,195.85, the aggregate of the two figures being $11,086,195.85. (Vol. II, pp. 273, 274, 701.) In connection with and to make possible the sale of the $10,000,000 of notes in that year Standard agreed to accept common stock of Deep Rock in payment of this large claim, and also agreed to accept common stock for 90,000 shares of preferred stock then owned by Standard. At the conclusion of the transaction Standard held nothing but common stock, with the exception of a comparatively small balance on the open account. Prior to the 1928 settlement Standard owned practically all of the common stock. In accepting additional common stock on the basis of one share for each $50 of the $11,000,000 indebtedness, as a practical matter Standard virtually surrendered its claim. As stated by the trustee in a formal statement distributed among the securityholders: "This transaction in no way injured the Deep Rock. It was beneficial to the Deep Rock and its preferred stockholders . . ." (Vol. II, p. 702.)

Petitioners erroneously state (Pet. Br. p. 60) that the reason for the cancellation of the open account was conceded to be a matter "of fair dealing to the preferred shareholders." The record shows that the claim was cancelled and the Standard preferred stock surrendered for common in order to issue Deep Rock notes, and that *the basis of conversion* of the preferred into common at $50 a share was adopted in fairness to the public preferred shareholders since that was the basis of their conversion rights. (Vol. II, pp. 68-69.)

Since the Standard claim which was compromised accrued after the 1928 settlement (as specifically found by the Circuit Court of Appeals—96 F. (2d) 693, 698; Vol. I, p. 483), the many transactions occurring prior thereto, and largely relied upon by petitioners, are immaterial.

The Circuit Court of Appeals has expressly found that the compromise eliminated all questionable items in the Standard claim which the trustee and his counsel felt were subject to disallowance on their merits, and that the transactions represented in the settlement resulted in benefit to Deep Rock and hence in no injury to the preferred stockholders. (96 F. (2d) 693, 701, 706; Vol. I, pp. 488, 498.)

The settlement figure of $5,148,463.54 was made up of two principal sums, as follows:

> (a) $2,376,076.31, being the principal amount paid by Standard (*after allowing Deep Rock credit for all payments made by it*) to Deep Rock or third parties not affiliated with Standard for the account of Deep Rock since the effective date (February 24, 1928) of the 1928 settlement of the Standard claim. In addition, interest at 5% per annum from the dates of the several advances constituting said sum to February 28, 1933 (the date of the commencement of the original equity proceeding), in the amount of $407,886.18, was added. It was also provided that the principal sum of $2,376,-

076.31 should draw interest at the rate of 5% per annum from February 28, 1933, to the date of the entry of the judgment on the offer of compromise.

(b) $1,585,485.18, being the amount actually expended by Standard in the purchase and development of the Refining Company properties less rentals which accrued prior to the 1928 settlement, for which Standard received common stock, and including interest to February 28, 1933.[4]

The total of the two principal sums ($2,376,000 and $1,585,400), with interest at 5% on the former sum to February 28, 1933 ($407,800) is $4,369,000—Standard's undisputed claim at the beginning of this litigation in February, 1933. The interest at 5% on the two principal sums to the date of the entry of the judgment on the compromise (February 3, 1937) brings the total claim as compromised to $5,148,463.54.

That the settlement includes these items *and no others* is plainly shown by the original offer of compromise by Standard, the acceptance of which was recommended by the trustee (Vol. I, pp. 105-107); by Exhibit B of the sworn reply of the trustee to the Taylor petition (being the memorandum dated February 21, 1935, approved by counsel for the trustee during the original settlement negotiations) (Vol. I, pp. 238-241); and by the interlocutory order approving the compromise entered by the District Court on December 22, 1936. (Vol. I, pp. 393-396.)

Included in the cash payments made by Standard to Deep Rock or to third parties since the 1928 settlement of the account are substantial sums for the redemption of Deep Rock bonds due in 1929, and amounts advanced for the

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[4]The method of computation of the $1,585,000 figure and the justification for its allowance are clearly described by counsel for the trustee in the communication addressed in the summer of 1935 by the trustee to the security holders of Deep Rock. (Vol. II, p. 704.)

ayment of interest and dividends to the public holders of Deep Rock securities, in addition to a number of smaller items covering taxes, bank trustees' services, materials, etc. The items with references to the record and description of their character can be found in the chart attached as Exhibit A to the brief of Standard, filed in this Court. That the open account included "charges for Deep Rock obligations and expenses paid by Standard directly to third persons" is expressly conceded by petitioners. (Pet. Br. pp. , 37.)

Since the offer of compromise included as an integral part thereof the transfer to Deep Rock of the capital stock of the Refining Company and the $1,800,000 Refining Company note held by Standard, fairness required the allowance to Standard of the amounts which it had in effect paid in the acquisition and development of the Refining Company properties ($2,500,000), plus interest. (Vol. II, p. 563.) But instead of allowing to Standard the full amount, there was deducted $1,475,000 (being the aggregate rentals for the Refining Company properties charged in the open account against Deep Rock prior to January 31, 1928), and only the difference of $1,585,485.18 was allowed. The effect was to consider the charges on open account of rental against Deep Rock prior to January 31, 1928 as an actual payment by Deep Rock of a part of the $2,500,000 expended by Standard. The rental charges before 1928 were, of course, never paid by Deep Rock, except through the issuance of common stock under the 1928 settlement. (Vol. II, p. 704; Vol. I, p. 239.) The payments made by Deep Rock to Standard after the 1928 settlement, which Standard applied on accrued rentals (Vol. I, p. 63; Vol. II, pp. 122, 123), were all credited to Deep Rock in computing the $2,376,076.31 principal sum of the compromise. While petitioners have vigorously attacked the Refining Company transactions, the note found on their Chart 3 (Pet. Br. p. 70A) credits

Standard with $2,544,591.11, being the amounts paid by it in the acquisition and development of the properties. The necessity and significance of this credit was observed by the Circuit Court of Appeals. (96 F. (2d) 693, 706; Vol. I, p. 498.)

Since Deep Rock was obligated to third parties for the several amounts paid by Standard subsequent to the 1928 settlement and had the benefit of cash advanced in the aggregate net amount of $2,376,076.31, and since Deep Rock in equity could not expect to acquire the Refining Company properties unless it made payment therefor, no question can legitimately be raised attacking the propriety of the items themselves which constitute the $5,000,000 settlement figure. This is clear from the record, which repeatedly shows that the $5,000,000 settlement *eliminates every debatable item in the Standard claim.* (Vol. II, pp. 389, 562, 563, 704.)

In the public statement mailed to the securityholders by the trustee with the approval of Mr. Ramsey, it is stated: "Standard's offer of compromise eliminates disputed items." (Vol. II, p. 704.)

The special master who heard all of the evidence submitted on the merits of the Standard claim and who filed his report recommending the original $5,000,000 compromise on May 11, 1935, stated (Vol. I, p. 201):

> " . . . the proposed compromise appears to be equitable from the standpoint of stockholders and creditors of the debtor corporation in that it only returns to Standard Gas and Electric Company the unpaid balance which upon accounting would probably be recovered by it with a low rate of interest and purged of any excessive or usurious charge . . ."

Counsel for the trustee, who litigated the Standard claim on its merits, stated in open court to the District Judge, upon the conclusion of the confirmation hearing (Vol. II, pp. 562-563):

"Now this compromise, as Mr. Gibson has explained, eliminates every fraudulent item in this claim of the Standard. . . . So, when you get down to this compromise, as Mr. Gibson said, we went over this, and this compromise does not allow the Standard any of these items that were contested by the trustee."

The Circuit Court of Appeals concluded as follows:

"The new offer eliminated all questionable items in the Standard claim which the trustee and his counsel felt were subject to disallowance on their merits." (96 F. (2d) 693, 701; Vol. I, p. 488.)

The compromise figure, therefore, does not include any allowance for rental on the Refining Company properties, for management fees, for compound interest, for dividends, or for any of the controverted items which were contained in the open account; nor does the compromise include any items from the open account arising prior to the 1928 settlement. The argument of counsel for petitioners in building up $19,898,000 of alleged wrongful items culled from the $52,529,000 of charges against Deep Rock *since 1919* is neither material nor persuasive, and is intended solely to divert the Court from a consideration of the actual facts.

The Items Included in the Compromise Figure Did Not Arise Out of Transactions in Which Standard and Deep Rock Had Adverse Interests.

It is true, of course, that all transactions between Standard and Deep Rock in which the interests of the parties were adverse, are voidable and subject to careful scrutiny by an equity court as to their fairness. This rule would be applied, for example, in connection with the determination as to whether the rental payments for the Refining Company properties were exorbitant or fair, and as to whether services were actually rendered by Standard which can support and justify the management fees charged to Deep Rock. Without exception, the cases which petitioners cite on this

point involved fact situations in which adverse interests did exist. But where the interests of the parties are not *adverse* the reason for the rule disappears.

Where Standard advanced cash to Deep Rock or expended money for Deep Rock's account in satisfaction of obligations due third parties, no presumption of fraud or special burden of proof can rest on Standard. The interests of Standard and Deep Rock were identical.

Thus, although contracts made by directors with their corporations are subject to the same tests of fairness as are contracts between corporations with interlocking directorates, it is universally held that a director may lend money to his corporation and take security therefor, without any imputation of unfairness. This result is plainly due to judicial recognition of the fact that in such cases the interests of the parties are not adverse since the debtor corporation simply promises to repay what it actually received and what its officer paid out.

Twin-Lick Oil Co. v. *Marbury*, 91 U. S. 587 (1875);
Sanford Fork Co. v. *Howe, Brown and Co.*, 157 U. S. 312 (1895);
Standard Lbr. Co. v. *Interstate Trust Co.*, 82 F. (2d) 346 (C. C. A. 5, 1936) cert. den. 299 U. S. 545 (1936);
Scully v. *Colonial Trust Co.*, 105 N. J. Eq. 309, 147 Atl. 776 (1929).

See also:

Render v. *Arkansas Valley Trust Co.*, 196 Fed. 1 (C. C. A. 8, 1912);
Dellert v. *Stallman*, 29 F. (2d) 236 (C. C. A. 7, 1928);
South Georgia Co. v. *Hiatt*, 2 F. Supp. 91 (D. C. Ga., 1933);
Fletcher on Corporations, Sec. 967.

The opinion of this Court in *Geddes* v. *Anaconda Copper Co.*, 254 U. S. 590 (1921), does not conflict with these principles, since there the interests were clearly adverse.

It is also clear that the compromise figure of $5,000,000 does not contain all of the items of the $9,342,000 claim which probably could be sustained on their merits. In the communication addressed by the trustee to the security-holders in August, 1935, a significant computation is made. It is there shown that after deducting from the $9,342,000 claim which accumulated subsequent to the 1928 settlement, interest charges claimed to have been excessive, Refining Company rentals, engineering and management fees, Refining Company income taxes, and dividends, there remains a balance in favor of Standard of $3,239,436.76. When to this figure is added the indebtedness of the Refining Company to Standard on its note, with interest, in the aggregate amount of $2,341,083.27 plus the cost of the Bradstreet properties, with interest, in the aggregate amount of $931,665.22, Standard would have a claim of $6,512,185.28. If the dividend[5] declared in December, 1928, of $840,672,

[5]Petitioners have tabulated a comparison of the earnings shown in the Deep Rock reports upon which dividends were declared, with the income tax returns which showed deficits in the computation of taxable income. (Pet. Br. p. 56A.) It must be remembered that under Delaware law dividends can be paid by a wasting asset corporation even though they are paid out of capital and before charges for depreciation and depletion, which charges are allowed by the government in computing income taxes.

In 1927 the Delaware General Corporation Act was amended, and Section 34 thereof now provides in part as follows:

> "Subject to any restrictions contained in its Certificate of Incorporation, the directors of any corporation engaged in the exploitation of wasting assets may determine the net profits derived from the exploitation of such wasting assets *without taking into consideration the depletion of such assets resulting from lapse of time or from necessary consumption of such assets incidental to their exploitation.*"

This statute has been construed and applied in *Wittenberg* v. *Federal Mining & Smelting Co.*, 15 Del. Ch. 351, 138 Atl. 352 (1927). An income tax liability and the right to pay dividends under Delaware law are two different subjects.

plus interest, making a total of $1,092,672, should be allowed Standard under the Delaware "wasting assets" rule (a result not at all unlikely, as conceded by the trustee) (Vol. II, p. 703), the items of the Standard claim which could be established (including the amounts which would have to be paid to acquire the Refining Company properties) would leave a balance in favor of Standard of $7,604,857.28. (Vol. II, pp. 702-3.) Therefore, the $5,000,000 settlement is some $2,600,000 less than the amount which the trustee, with the approval of his counsel, actually predicted might be allowed if any claim at all could be established as a matter of law.

The fact of the matter is that the compromise figure involves no disputed items, and the sole basis, even of argument, involves the question as to whether or not the District Judge abused his discretion in permitting the compromise because of the supposed applicability to the situation of the so-called "instrumentality rule."

2. The So-called "Instrumentality Rule" Is Not a Fixed Principle of Law, and Could Not Have Been Considered by the District Judge as Imperatively Operative to Defeat an Otherwise Legitimate Claim.

The most important single contention of the petitioners appears to be that because of the instrumentality rule every part of the Standard claim must necessarily be subordinated as a matter of law to the claim of the preferred stockholders of Deep Rock. This position we respectfully submit was erroneously adopted by the dissenting Circuit Judge.[6]

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[6]It is obvious that the Hon. Sam G. Bratton, the dissenting Circuit Judge, was largely influenced by a misconception that the excessive rentals for the Refining Company properties were paid by Deep Rock to Standard and that Standard was thereby "substan-

We submit that basic equitable principles upon which the instrumentality rule rests not only failed to provide any justifiable ground for refusing to approve the compromise of the Standard claim but actually furnished strong support for the validity of the claim in at least the compromise figure. *The decision of the District Judge in approving the compromise of the Standard claim is supported by each of the following four considerations, any one of which is sufficient to bar a finding that the District Judge abused his discretion:*

(a) The instrumentality rule, being expressed in general terms relating to "dominion" or "control", is not a fixed principle of law which can be applied with predictable certainty.

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tially enriched". (96 F. (2d) 693, 710; Vol. I, p. 504.) The record shows that the rental payments accruing on the Refining Company lease were charged against Deep Rock on the Standard open account. (Vol. II, pp. 76, 95, 132, 133, 153.) The claim existing in 1928, including the rentals accrued prior thereto, was satisfied by Standard's acceptance of common stock. (Vol. I, p. 58; Vol. II, pp. 68, 114, 273, 274, 426, 701.) All payments by Deep Rock to Standard since the 1928 settlement of the open account, including those applied by Standard on rentals, have been credited to Deep Rock in the computation of the $5,000,000 compromise figure, and the net balance only allowed to Standard. (See this brief, pp. 45-48.) The only recognition of the Refining Company transaction contained in the compromise is to repay to Standard the amount of its funds actually expended in the acquisition and development of the Bradstreet Acreage and cracking plant (in excess of $2,500,000), less the amount of rentals accrued prior to the 1928 settlement, for which Standard received only common stock. It is therefore clear that Standard was never enriched at the expense of Deep Rock in connection with the Refining Company transactions and that under the compromise Standard is not allowed one cent of rental, but only a partial return of the capital expended by it in the acquisition and development of the properties which, pursuant to the compromise, are to become the property of Deep Rock. The Circuit Court of Appeals expressly found that "Deep Rock did not pay the rentals as they accrued" and that setting aside the Refining Company transaction "would increase rather than decrease the claim". (96 F. (2d) 693, 698, 706, Vol. I, pp. 482, 498.)

(b) The basic considerations upon which the instrumentality rule rests prevent its applicability under the circumstances of this case.

(c) The instrumentality rule must be invoked on behalf of creditors, and not contributors of capital, including preferred stockholders.

(d) The instrumentality rule is a rule of equity and cannot successfully be invoked when the result would be fundamentally unjust.

(a) The instrumentality rule, being expressed in general terms relating to "dominion" or "control", is not a fixed principle of law which can be applied with predictable certainty.

No one can predict with certainty, in any particular situation involving vicarious inter-corporate liability, what would be the final result of litigation. The language of the courts to the effect that where one corporation so dominates and controls another that it is but a mere instrumentality or department of the former, the court will look through the corporate entity and face realities, is rhetorically attractive but devoid of precision. As the late Justice Cardozo aptly observed, ". . . the whole problem of the relation between parent and subsidiary corporation is one that is still enveloped in the mists of metaphor." *Berkey* v. *Third Ave. Railway*, 244 N. Y. 84, 91, 155 N. E. 58, 61 (1926.)

In a recent and highly illuminating book written by Elvin R. Latty, Professor at Law at Duke University (formerly at the University of Missouri) and member of the New York Bar, entitled *Subsidiaries and Affiliated Corporations* (The Foundation Press, Inc., Chicago, 1936), the most scholarly and exhaustive treatment of the problem in general and the "instrumentality rule" in particular, can be found. The author says:

*"As will be shown * * * any hope of establishing a satisfactory line of cleavage between the cases on the ground that the debtor corporation in question was controlled too much or was too completely dominated must soon vanish.** True enough, when the claim was disallowed the court seldom failed to observe that the corporate entity will be disregarded when the corporation is so controlled and dominated that it becomes a 'mere instrumentality' and to point out that the debtor corporation in question was 'really' the claimant or was but 'the instrumentality' or 'adjunct' of the claimant. What is not frequently pointed out is that there was just as much control and domination and that the debtor was just as much an 'instrumentality' (whatever that may be) in the cases which allowed the claim of the parent, affiliate, or sole stockholder on an equal footing with other claims." (Pp. 142-143.)

It is obvious that the language about "dominion" and "control" found in the cases is too indefinite to be helpful. The petitioners' brief (p. 29) speaks at length about "control" of the subsidiary and states the rule with meaningless generality and vagueness, as follows:

> ". . . Where, however, one corporation so fully controls and dominates another for its own ends as to make the latter, in effect, its own agency or instrumentality, the courts have applied the instrumentality rule to impose upon the dominating parent company its true position as the owner, principal, or real party in interest."

The unsatisfactory nature of the "control" approach to the problem is best demonstrated in the opinion of Mr. Justice Cardozo in *Berkey* v. *Third Avenue Railway Co.*, 244 N. Y. 84, 155 N. E. 58 (1926.) In that case the subsidiary corporation operated a division of the New York City transit system. Its routes were physically connected with the routes

*Italics ours throughout, unless otherwise noted.

of other subsidiaries of the dominant parent. The executive officers of each of the divisions and of the parent were the same. These officers operated each of the corporations—a situation which even at casual reading appears far more appropriate for the strict application of the instrumentality rule than the situation before this Court. All the street cars were marked "Third Avenue Railway System", and were owned by the parent and leased to the subsidiary. The purchasing department, the legal department, the accounting department, the repair department, the pension system, the paymaster and all his assistants, the training school for all employes, the printing work for all the companies, the Liberty Loan drive among employes, and all payments of general and miscellaneous expenses for the entire system were controlled and operated by the parent and paid for by it in the first instance. Yet, in that case Justice Cardozo refused to apply the rule.

The case involved an injury to the plaintiff while leaving a street car of the Forty-Second Street Railway Co., caused by the negligence of the motorman. The plaintiff sued the Third Avenue Railway Company, which owned substantially all of the stock of the Forty-Second Street Railway Company. Upon appeal the Court of Appeals of New York dismissed the complaint, holding that the instrumentality rule did not apply:

> "We are unable to satisfy ourselves that such dominion was exerted. The Forty-Second Street Company deposits in its own bank account the fares collected on its route. It pays out of that account and no other the wages of the motormen and conductors engaged in the operation of its cars. *It was not organized by the defendant as a decoy or a blind.* . . . Through all the intervening years it has preserved its corporate organization, with property adequate to the maintenance of life. Its balance sheet for the year end-

ing July, 1917, shows assets of $12,456,847.86. . . . In no possible view . . . are they unsubstantial or nominal . . . it was functioning as a corporation continuously and actively. . . .

"The question is whether other circumstances yet to be noted neutralize these indicia of separate life and operation. The defendant, as we have seen, was the owner, in 1916, of *substantially all the stock* of the subsidiary corporation. Its president in reporting to the stockholders the financial situation at the end of the fiscal year informed them that to make the picture accurate, the statement must exhibit the consolidated income, and this was obviously true. Other ties must be shown in addition to the one resulting from ownership of shares. The members of the two boards of directors were *nearly though not quite, the same.* Each road had *the same executive officers,* i. e., the same president, treasurer, general manager, paymaster and counsel. The parent has made *loans to the subsidiary* from time to time, sometimes for construction, sometimes for operating expenses." (155 N. E. at 58.)

In discussing the legal aspect of the parent and subsidiary relationship, Justice Cardozo stated:

"The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an 'alias' or a 'dummy'. *All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation.* Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice. *Ballantine, Parent and Subsidiary Corporations,* 14 Cal. Law Review, 12, 18,

19, 20. The logical consistency of a juridical conception will indeed be sacrified at times, when the sacrifice is essential to the end that some accepted public policy may be defended or upheld. This is so, for illustration, though agency in any proper sense is lacking, where the attempted separation between parent and subsidiary will work a fraud upon the law. *Chicago, M. & St. P. R. Co.* v. *Minneapolis Civic & Commerce Ass'n*, 247 U. S. 490, 38 S. Ct. 553, 62 L. Ed. 1229; *United States* v. *Reading Co.*, 253 U. S. 26, 61, 63, 40 S. Ct. 425, 64 L. Ed. 760. At such times unity is ascribed to parts which, at least for many purposes, retain an independent life, for the reason that only thus can we overcome a perversion of the privilege to do business in a corporate form. We find the case at hand neither agency on the one hand, nor, on the other, abuse to be corrected by the implication of a merger. On the contrary, merger might beget more abuses than it stifled. Statutes, carefully framed for the protection, not merely of creditors, but of all who travel upon railroads, forbid the confusion of liabilities by extending operation over one route to operation on another. In such circumstances, we thwart the public policy of the state instead of defending or upholding it, when we ignore the separation between subsidiary and parent and treat the two as one." (155 N. E. at 61.)

There is no occasion to burden this Court with a discussion of the many other decisions in comparable situations of "control" where the instrumentality rule was not applied and where the rights of the parent corporation were sustained.[7]

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[7]Illustrative cases in which the parent, affiliate or sole stockholder was allowed to share *pari passu* in the insolvent estate of the bankrupt corporation even though exercising "control":

Duffy v. *Treide*, 75 F. (2d) 17 (C. C. A. 4, 1935)
Finn v. *Geo. T. Mickle Lbr. Co.*, 41 F. (2d) 676 (C. C. A. 9, 1930)
First Nat. Bank v. *Young's Estate*, 41 F. (2d) 8 (C. C. A. 6, 1930)

Petitioners' Authorities.

Petitioners begin their discussion of the instrumentality rule by the citation of seven decisions of this Court. Not one of these cases involves facts remotely similar to the situation here. Four of the seven cases cited deal with governmental regulation of railroads. Three of these four cases (*United States* v. *Lehigh Valley R. Co.*, 220 U. S. 257 (1911); *United States* v. *D. L. & W. R. Co.*, 238 U. S. 516 (1915); and *United States* v. *Reading Co.*, 253 U. S. 26 (1920)) involve the enforcement of the commodities clause of the Hepburn Act. Interstate Commerce Act, Sec. 1 (8),

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Wheeler v. *Smith*, 30 F. (2d) 59 (C. C. A. 9, 1929)
Martin v. *Development Co.*, 240 Fed. 42 (C. C. A. 9, 1917)
Peckett v. *Wood*, 234 Fed. 833 (C. C. A. 3, 1916)
In re Watertown Paper Co., 169 Fed. 252 (C. C. A. 2, 1909)
Salomon v. *Salomon & Co.* [1897] A. C. 22
In re Kalamazoo Bldg. Co., 21 F. Supp. 852 (W. D. Mich., 1937)
In re Pneumatic Tube Co., 60 F. (2d) 524 (D. C. Md., 1932)
Vennerbeck & Clase Co. v. *Juergens Jewelry Co.*, 53 R. I. 135, 164 Atl. 509 (1933)
Erkenbrecher v. *Grant*, 187 Calif. 7, 200 Pac. 641 (1921)
Briggs & Co. v. *Harper Clay Products Co.*, 150 Wash. 235, 272 Pac. 962 (1928)
Lange v. *Burke*, 69 Ark. 85, 61 S. W. 165 (1901)

Illustrative cases in which a parent was held not liable on the contracts of the subsidiary even though "control" was exercised:

Gillis v. *Jenkins Co.*, 84 F. (2d) 74 (C. C. A. 9, 1936)
Majestic Co. v. *Orpheum Circuit*, 21 F. (2d) 720 (C. C. A. 8, 1927)
New York Trust Co. v. *Carpenter*, 250 Fed. 668 (C. C. A. 6, 1918)
Richmond & I. Const. Co. v. *Richmond, N. I. & B. R. Co.*, 68 Fed. 105 (C. C. A. 6, 1895)
Hooper Co. v. *Matthew Addy Co.*, 4 F. (2d) 187 (C. C. A. 6, 1925)
Universal Oil Co. v. *Derby Corp.*, 19 F. Supp. 821 (D. C. N. J., 1937)

49 U.S.C.A. 1 (8). The purpose of the commodities clause was to end discriminations of various kinds which followed whenever a railroad acted both as a public carrier and a private shipper. The statute specifically forbade the transportation of commodities produced either by a railroad or "under its authority . . . or in which it may have any interest, direct or indirect. . . ." In refusing to sanction the use of a subsidiary or affiliated corporation acting under the "authority" of the railroad in question, this Court merely gave effect to the purpose of the statute and enforced its actual provisions. As stated in *United States* v. *Reading Co.*, 253 U. S. 26, 62:

Berry v. *Old South Engraving Co.*, 283 Mass. 441, 186 N. E. 601 (1933)

Finley v. *Union Bank*, 281 Mich. 214, 274 N. W. 768 (1937)

Pagel Horton & Co. v. *Harmon Co.*, 258 N. Y. S. 168 (1932)

See also:

Cannon Co. v. *Cudahy Co.*, 267 U. S. 333 (1925) (jurisdiction for suit)

Gideon-Anderson Co. v. *St. Louis Ry. Co.*, 88 F. (2d) 222 (C. C. A. 8, 1937)

Atherton v. *Anderson*, 86 F. (2d) 518, 536 (C. C. A. 6, 1936); reversed on another point in 302 U. S. 643 (1937) (claim against bank officers and directors for mismanagement)

McLean v. *Goodyear Co.*, 85 F. (2d) 150 (C. C. A. 5, 1936); cert. den. 299 U. S. 600 (1936) (subsidiary's liability for tort of parent)

Shepherd v. *Banking Co.*, 79 F. (2d) 767 (C. C. A. 6, 1935); cert. den. 297 U. S. 717 (1936) (assets in bankruptcy)

Mas v. *Nu-Grape Co. of America*, 62 F. (2d) 113 (C. C. A. 4, 1932) (jurisdiction for suit)

Bee Bldg. Co. v. *Daniel*, 57 F. (2d) 59 (C. C. A. 8, 1932) (assets in bankruptcy)

Owl Corporation v. *California Co.*, 30 F. (2d) 812 (C. C. A. 3, 1929) (patent infringement)

Lowendahl v. *B. & O. R. Co.*, 272 N. Y. 360, 6 N. E. (2d) 56 (1936)

Hoffman Wallpaper Co. v. *City*, 114 Conn. 531, 159 Atl. 346 (1932)

". . . It would be to subordinate reality to legal form to hold that the coal mined by the Coal Company under the direction of the Holding Company's officials, was not produced by the same 'authority' that operated the Reading Railway lines. The case falls clearly within the scope of the act, and for the violation of this commodity clause, as well as for its violation of the Anti-Trust Act, the combination between the Reading Railway Company and the Reading Coal Company must be dissolved."

The fourth case involving the regulation of railways (*Chicago, M. & St. P. Ry. Co.* v. *Minneapolis Civic and Commerce Assn.*, 247 U. S. 490 (1918)) dealt with the incorporation by two railroads of a pure dummy, which operated an insignificant portion of track serving certain industries under a contract which deprived the subsidiary of all powers, with the result that shippers over the track in question suffered from discrimination.

It is apparent that cases involving the enforcement of regulatory statutes bear no relation to the question as to when a parent shall be held liable for the financial engagements of its subsidiaries.

The remaining three decisions of this Court cited by petitioners are equally inapplicable to the instant case:

In *McCaskill Co.* v. *United States*, 216 U. S. 504 (1910) the Court merely enforced the familiar principle that the knowledge of a corporate officer must be imputed to the corporation where their interests are not adverse.

In *Hart Steel Co.* v. *Railroad Supply Co.*, 244 U. S. 294 (1917), the Court determined that under the doctrine of *res judicata* the final decree in a patent infringement proceeding in favor of a manufacturer should determine the

issues in an identical suit brought by the same plaintiff against the manufacturer's sales agent and its manager. The instrumentality rule was not even remotely involved.

In *Davis* v. *Alexander*, 269 U. S. 114 (1925), the Court held that where one railroad operates its own lines and those of another corporation "as a single system" the dominant company can be held for the negligence of the subsidiary. The fixing of liability upon the actual wrongdoer for negligence is totally different from imposing liability on a parent corporation in favor of one who voluntarily became a stockholder of a subsidiary.

One of the best analyses of the so-called "control" test is that of William O. Douglas, now chairman of the Securities and Exchange Commission, and C. M. Shanks, of the New York Bar, in 39 Yale Law Journal 193. They state categorically as follows (p. 196):

> "The observance of the following four standards will keep the business units from being treated as assimilated: (1) A separate financial unit should be set up and maintained. . . . (2) The day to day business of the two units should be kept separate. . . . (3) The formal barriers between the two management structures should be maintained. . . . (4) The two units should not be represented as being one unit."

With particular reference to claims upon contract the same article states (p. 211):

> " . . . The very reasonable question must be met and answered why one who contracted with the subsidiary and received the promise which he bargained for but who has been disappointed in the fulfillment by the subsidiary of its commitment should then be allowed to look to the parent. As a matter of contract right it is evident he may not. Additional compelling facts must appear."

And the article concludes (p. 217):

"From the foregoing it will be seen that where contractual rights are concerned *the contents of any rules which may be stated to help in the work of prediction are but shifting and faintly outlined at the best, themselves uncertain subjects of predictability.* . . .

"As yet the subject is covered with a 'mist of metaphors.' Until the courts stop to analyze with more particularity the factors motivating their decisions before lapsing into phrases such as 'alter ego' or 'adjunct' or 'instrumentality' there seems little hope of making prediction more certain than the foregoing."

It is perfectly clear in this case that Deep Rock satisfactorily meets all of these tests. It was "a separate financial unit" with a separate "day-to-day business" which was under control of its own officers, holding separate monthly meetings of its board of directors, maintaining separate offices (over 600 miles from Standard's offices), and paying its own employes. (Vol. I, pp. 174, 480-81; Vol. II, pp. 387, 561, 703.) Certainly everyone dealing with Deep Rock recognized it as a unit separate from Standard. The Circuit Court of Appeals discussed these questions and made the following specific findings:

"Deep Rock was not organized as a department of Standard. Each kept separate and distinct corporate records and books and the properties and assets of the former were not commingled with those of the latter. Deep Rock paid its own officers and employees. The offices of Deep Rock were first maintained at Chicago. Soon after Mr. Gray became executive vice-president and general manager they were moved to Tulsa, Oklahoma. The officers at Tulsa held frequent consultations with the officers and directors of Deep Rock in Chicago upon questions of acquiring additional gasoline stations, oil and gas leases, and other oil properties, and with reference to financing and general business policies. These conferences were consultive in char-

acter. The officers at Tulsa were in actual charge of the operations and affairs of Deep Rock and were not dictated to by Standard or its officers." (96 F. (2d) 693, 697; Vol. I, pp. 480-81.)

That the operating officers of Deep Rock had absolute freedom in conducting the oil business of the corporation is clearly supported in the record. (Vol. II, pp. 40, 41, 231.) The operations failed as a result of an unprecedented business depression and a failure to develop valuable producing properties in the course of the extension program. In discussing the contention that the management fees charged on the open account had no foundation in fact, petitioners assert that "Deep Rock's oil business was actually handled by its operating officers who were well experienced in the oil business and were being paid large salaries by Deep Rock." (Pet. Br. p. 52.) This is hardly consistent with the fundamental claim repeatedly made by petitioners (Pet. Br. p. 39) that Deep Rock was completely dominated and run by Standard as a department of its business.

Petitioners urge that the alleged "*departmental operation*" of Deep Rock is evidenced by the payment by Standard of bills and expense items incurred by Deep Rock. (Pet. Br. p. 37.) While some expenses were, as a matter of convenience, paid in this way and charged to Deep Rock on open account, the great bulk of Deep Rock money was spent by its own operating personnel without participation by Standard. This is not a case where a subsidiary had no bank account, drew no checks, paid no bills. While some items were paid by Standard, they were but a fraction of the expenses of operating an oil company which were paid by Deep Rock in the ordinary course. This is made strikingly apparent when it is remembered that since the 1928 settlement of the open account the gross earnings of Deep

Rock have exceeded $80,000,000. (Vol. II, pp. 40, 42, 35, 232, *et seq.*, 650.)

The District Judge therefore, in approving the compromise of the Standard claim, was dealing with a field of law perhaps the most technical and difficult of observable result with which we are acquainted. Any situation involving the rights of thousands of individuals which depends upon such uncertain elements is obviously ripe for settlement. *If discretion should ever be exercised to avoid the uncertainties of result, it was proper to exercise it here.*

(b) The basic considerations upon which the instrumentality rule rests prevent its applicability under the circumstances of this case.

It is important to analyze the theoretical basis of the cases relied upon by petitioners which deny the claim of a parent corporation asserted against a subsidiary on the ground of dominion or control. The real reason, when mere words are disregarded and the decisions are "shorn of verbiage" and the "mists of metaphor", for subordinating a parent to *other creditors* of a subsidiary can be found in the fundamental theory of the corporation as a distinct person. While corporations are legal devices by means of which stockholders as owners of the enterprise may enjoy personal immunity from liability, such immunity depends upon the contribution of capital *which can be reached.*

Where a subsidiary is formed to carry on a department of the enterprise itself, and the creditors of that subsidiary, because of the introduction of the second entity, namely, the subsidiary, cannot reach the capital contributed by the actual stockholders, the result is "inequitable", and the entity of the subsidiary is disregarded and the so-called instrumentality rule applied. This is done to prevent the stock-

holders of the enterprise from having, in addition to their limited liability, a second insulation which protects even the contributed capital.

It follows that it is extremely important to determine whether or not the subsidiary (which is not of itself unlawful) actually transacts a department of the parent's business to the capital of which the subsidiary's creditors have a right to look for satisfaction. For this reason counsel for the trustee in approving the compromise, as is shown in the record, placed strong reliance upon the facts that Deep Rock was never organized as a department of Standard; that the assets of Deep Rock and Standard were never commingled; that Deep Rock always maintained its own offices and books and always controlled its own operations in the oil business; and that Standard, which was an investment or holding company, was never in the oil business. (Vol. II, pp. 387, 561, 703.)

As is stated by Mr. Latty, in considering the action of the courts in the instrumentality rule cases (pp. 195-197):

> "What the courts are actually doing when they hold the stockholder [the parent] liable for what normally is a liability of the corporation alone is to *deny limited liability*. . . .
>
> "Once attention is focused on the denial of limited liability, rather than on some mystical aspect of what a corporation is, entirely disconnected from the pragmatic aspect of what it does, the significant difference between the corporate and individual stockholder suggests itself. . . . The difference is simply that the parent corporation *has already achieved limited liability*, or rather, its stockholders have; in other words, in allowing recovery against the parent, there is *no denial of limited liability* so long as the recovery does not go back of the parent to reach its stockholders and subject *them* to unlimited liability. But if in allowing recovery

against the parent there is no complete denial of limited liability, there is very obviously a limitation of that accepted principle. This limitation is achieved by recognizing in law what is an economic fact in nearly all the parent-subsidiary cases that are reported, viz., that the parent with all its subsidiaries and sub-subsidiaries *constitutes a single economic unit.* So long as recovery is limited to the pool of assets of the entire unit and *only* to that pool the individual stockholders of the entire incorporated unit are enjoying limited liability, however much the obligations of particular divisions of the single economic enterprise are shifted about within the enterprise. When such shifting is permitted and yet the liability of the individual stockholder or stockholders is denied, what the court is saying to him or them in effect is this: 'True, you may incorporate your business and if you do, the assets of the business and those assets alone shall answer for the obligations incurred in the conduct of the business; however, once you have thus placed a limit to your personal liability, the social need for limited liability has been met and the law, in turn, puts a limit to the extent to which you can divide and subdivide your business enterprise into a number of legal compartments each with their own exclusive obligations; there are limits to limited liability.' . . . The pertinent question is: Should and do the courts permit the re-limiting of liability, within a field already limited through incorporation of the business unit, to such divisions, and subdivisions as the owners see fit to make?"

And, at p. 211:

". . . But when the authors of such a decision [instrumentality rule case] assure one that the top company 'dominated,' 'interfered too much,' 'intermeddled directly,' made the subsidiary its 'mere agent or instrumentality,' and therefore is liable, it is asking too much of one to ignore the fact that the real basis of the decision is some theory, along the lines herein suggested, *that the enterprise and not the injured*

> *claimant should bear the loss.* Allowing recovery against other corporations having ultimate identity of stock interest with the insolvent obligor, *and which constitute with it a single economic enterprise,* is sound in principle, squares with what courts *do* and even with what they *say,* viz., that they pierce the corporate entity to reach an 'equitable result'."

This conception is well stated and enforced by the Circuit Court of Appeals for the First Circuit in the case of *Holbrook, Cabot & Rollins Corp.* v. *Perkins,* 147 Fed. 166 (C. C. A. 1, 1906) where a construction company, after contracting to build a dam, canal and power house, organized an affiliate without capital, to which it sublet the contract. In striking down this attempt to insulate from liability the capital of the enterprise, the court said (pp. 169-170):

> "It is quite true that individuals are permitted to form corporations for the purpose of conducting business with a limited individual responsibility. It is not true that individuals are permitted to form corporations solely for the purpose of avoiding ordinary legal liabilities. Incorporation is permitted in furtherance of business enterprises; but a franchise is not granted for the sole purpose of destroying legal accountability. If the Holbrook, Cabot & Rollins Corporation had put out of its hands all of its property merely in order to avoid legal liability for torts which it might commit in the course of its operations, we think there can be no question that such a conveyance would be void. We see no substantial difference in the arrangement made in this case. Instead of putting its property out of the hands of Holbrook, Cabot & Rollins Corporation, the persons associated in that corporation attempted to put out of its hands the work authorized by its franchise, and for which the corporation was created, and thus, by an artificial division of its work and property, secure for the joint operations of the two corporations an immunity which could not be secured for the principal corporation. The immunity from attach-

ment accruing to the Atlantic Construction Company is to be due to the fact that it will have no attachable assets. The immunity of the Holbrook, Cabot & Rollins Corporation is to be due to the fact that it will put all of its contracts into other hands. This arrangement between the Atlantic Construction Company and the Holbrook, Cabot & Rollins Corporation was merely a piece of circumvention which may be regarded either as a nullity, or as making the Atlantic Construction Company the agent, ..."

The soundness of this analysis is made strikingly apparent by the fact that substantially all of the analogous instrumentality rule cases present the same picture: a subsidiary with little or no capital carrying on an important part of the parent's business. For this reason reliance is placed by petitioners on the asserted ground that Deep Rock has always been grossly undercapitalized. (Pet. Br. p. 39.) Counsel has cited that group of cases which impose liability upon a parent corporation in favor of a claimant against a subsidiary where a subsidiary was formed to transact a division of the parent's business and was set up with a capital completely inadequate for the purpose.

In *Luckenbach S. S. Co.* v. *W. R. Grace Co.*, 267 Fed. 676 (C.C.A. 4, 1920), cert. den. 254 U. S. 644, the Luckenbach Company leased eight valuable steamships owned by it to an affiliated corporation, which was capitalized at only $10,000. When the lessee breached a contract under which its liability was over $1,300,000 the courts properly held the lessor liable.

In *Maloney Tank Mfg. Co.* v. *Mid-Continent Petroleum Corp.*, 49 F. (2d) 146 (C. C. A. 10, 1931), the subsidiary had *little or no capital* and the Circuit Court of Appeals for the circuit in which the case at bar began, said, *in 1931* (p. 148):

". . . The sales corporation used the former office of the Tank Company [parent] at Seminole, no change

being made in the signs on the windows. The Tank Company sent out all the bills to the public for tanks sold or work done by the sales corporation and collected the money therefor. *The Tank Company followed this practice because the sales corporation was not financially able to take care of the business, and for the protection of the Tank Company.*"

In *Joseph R. Foard Co.* v. *State of Maryland*, 219 Fed. 827 (C. C. A. 4, 1914) the parent had organized a subsidiary with only $2,000 capital, and through that subsidiary was carrying on an important stevedoring business.

In the case *In re Kentucky Wagon Mfg. Co.*, 71 F. (2d) 802 (C. C. A. 6, 1934), also cited by petitioners, the subsidiary corporation had *no capital* whatever and did business only on loans made by the parent company; no shares of stock were ever issued. The claims of the parent for over $2,800,000 were disallowed.

In *Clere Clothing Co.* v. *Union Trust & Savings Bank*, 224 Fed. 363 (C. C. A. 9, 1915), also cited by petitioners, the parent endeavored to assert a claim of over $32,000 as a creditor of the subsidiary, although it appeared that substantially the only assets which the subsidiary had ever possessed were the same goods on which the claim was based. Here, as in the other cases above cited, the parent, even if its claim be accepted at face value, had never taken any substantial risk in the operation of its subsidiary. It sought to insulate virtually all of the working capital from the hazards of business in which its subsidiary was engaged.

No such criticism can be leveled at Deep Rock.

Its original assets were estimated to have a value of more than $15,500,000. (Vol. I, p. 173.) It is true that Deep Rock was frequently short of cash, particularly for ex-

pansion, but its fixed assets were always substantial. The Circuit Court of Appeals found that Standard made frequent advances and loans of funds to Deep Rock when Deep Rock's liquid assets "would not have been sufficient to take care of the cost of expansion and current requirements," and concluded that as the parent is the natural source of the subsidiary's credit the fact that the parent finances the subsidiary will not render it a mere instrumentality. (96 F. (2d) 693, 697, 705; Vol. I, pp. 481, 496-97.)

Deep Rock's assets have not been mingled with those of Standard, and its capital was and is ample to satisfy all of its creditors. It is obvious that the Deep Rock oil business was not a mere division of a business enterprise conducted by Standard. *These facts are enough by themselves to bar the operation of the instrumentality rule altogether. The least that can possibly be said is that they make its application so open to doubt as to make the matter properly one for compromise.*

(c) The instrumentality rule must be invoked on behalf of creditors, and not contributors of capital, including preferred stockholders.

No reported case has ever invoked the instrumentality rule in favor of preferred stockholders. This fact by itself is enough to justify the compromise, since it shows that petitioners' claims are completely opposed by precedent and therefore are, at the very least, the proper subject of compromise. The District Judge, in overruling petitioners' objections to the compromise of the Standard claim, did not deal with the rights of creditors of a subsidiary. Petitioners are preferred stockholders of Deep Rock; they are not creditors. They did not extend credit to an enterprise owned and operated by Standard; they bought preferred stock of Deep Rock; they contributed capital for a distinct

and separate enterprise, namely, the oil business of Deep Rock. Further, petitioners are not in the position of creditors who either thought they extended credit to the parent or who became involuntary creditors of a subsidiary operated as a division of a parent's business with inadequate capital. There is no case which goes beyond the subordination of the parent's claim to other *creditors* of the subsidiary.

The logic of this distinction is clear when one considers the remedies available to stockholders, particularly prior to insolvency. Stockholders are adequately protected by their right to object to specific acts of mismanagement and to prevent loss resulting from an abuse of "control" or "domination." *Geddes* v. *Anaconda Copper Co.*, 254 U. S. 590 (1921); *Twin-Lick Oil Co.* v. *Marbury*, 91 U. S. 587 (1875). On the other hand, creditors have no power to object to the conduct of the internal affairs of a corporation until insolvency actually intervenes or is close at hand. *McCandless* v. *Furlaud*, 296 U. S. 140, 163 (1935); *McDonald* v. *Williams*, 174 U. S. 397, 403 (1899). Hence, the instrumentality rule has been applied in their behalf although it is unnecessary to invoke the doctrine for the adequate protection of preferred stockholders.

The only case of which we have knowledge where the same contentions that are being made here were also made is *In re Davison Chemical Co.*,[3] a 77B case decided by the District Court of Maryland on October 17, 1935. In that case the preferred stockholders of the subsidiary debtor contested the allowance of claims of the parent company on the ground that the subsidiary was merely an instrumentality and had been grossly mismanaged by the parent, and that consequently the claims of the parent should

[3]The Daily Record, Baltimore, Md., Monday, October 21, 1935; *C. C. H. Bankruptcy Service*, Par. 3656, p. 1689.

subordinated to the claims of the debtor's preferred stockholders. But the court said:

"It is apparent that the preferred stockholders to prevail as to subordination of the Davison Chemical Company [parent] must establish (1) that the doctrine of parent and subsidiary corporations may be expanded for the benefit of preferred stockholders as contrasted with outside creditors and (2) that the Davison Company as the parent corporation has been guilty of elements of fraud and estoppel with respect to the preferred stockholders. *As to the first proposition, counsel have been unable to find any adjudicated case which has made or indicated there should be made an extension of the doctrine here contended for on behalf of the preferred stockholders.* The basic principle which establishes in proper cases the liability of the parent corporation to outside creditors of the subsidiary, or correlatively the subordination of the parent company's claim to that of outside creditors in the distribution of the assets of the subsidiary, is that the parent has in effect used the subsidiary as its mere agent or instrument and that the debts owing to outside creditors are really therefore the debts of the parent; and for this purpose the corporate fiction of the subsidiary is disregarded. *It seems obvious that this principle cannot properly be extended for the benefit of preferred stockholders who are, of course, not creditors but part owners of the corporate assets.* In this case the interests of the preferred stockholders in the corporation long antedate the activities of the Davison Chemical Company. It cannot be said that the rights of the preferred stockholders were in any way created by the Davison Company on any theory of agency. If the Eastern has been mismanaged by Davison, the remedy available to the preferred stockholders is a damage suit against the individual officers and directors of the Eastern who may be liable and, of course, also against the Davison Company if it can be shown that the mismanagement was attributed to the corporate entity. To the extent that such liability can

be established and damage proved it may very well be that Eastern as a corporation would have a claim against Davison which would be an offset or deduction from Davison's otherwise valid claim. *But this is quite different from subordinating the whole of the Davison claim* to the interests of the preferred stockholders."

The facts of *In re Van Camp Products Co.*, 95 F. (2d) 206 (C.C.A. 7, 1938), cert. den. 59 S. Ct. 65 (1938), are strikingly similar to the instant case. There preferred stockholders objected to the compromise of a claim of an affiliated company ahead of the preferred stock, and asserted large counterclaims against the affiliate. The compromise approved included only the part of the claim which was clearly established, although the record showed "reckless and irresponsible financing." (Id. at 208.) The evidence also showed that an important part of the business of the bankrupt was done under contracts made by interlocking boards of directors and by common officers. The approval of the compromise was affirmed by the Circuit Court of Appeals. Apparently recognizing that the instrumentality rule had no applicability, counsel for the objecting preferred stockholders in no way suggested that the instrumentality rule barred the compromise allowance of the valid items.

A parallel situation was considered by the Court of Appeals of Kentucky in the case of *Fryer* v. *Wiedemann*, 148 Ky. 379, 146 S. W. 752 (1912). In that case two dominant individual common stockholders had continually advanced sums of money to the corporation. Preferred stockholders sought to subordinate the claims based on such loans. The court held (p. 755):

". . . While it may be true that a director, in becoming a creditor of a corporation, may not take advantage of his position and obtain any preference over other creditors, it is well settled that he may, in good

faith, make a loan to the corporation. (Citing cases.) This is all that appellees did in this case. Having in good faith advanced the money to the corporation, they are entitled to share in the distribution of the assets upon the same terms as the other unsecured creditors."

t is not strange that the extension of the instrumentality e in the interests of a subsidiary's preferred stockholder been refused. To do so would involve a misconception he actual theory of the rule. The preferred stockhold- by the very act of buying the preferred stock of the sub- ary, contributed capital to that corporation and did not end credit to the enterprise of which it is contended that subsidiary simply operates a division. If the instrumen- ty rule should be so extended, it is inconceivable that a ent corporation's claim which consists of money ad- ced to the subsidiary or expended to satisfy obligations he subsidiary senior to the preferred stockholders, would subordinated to such shareholders. We have shown that $5,000,000 compromise figure consists only of such items.

The instrumentality rule is a rule of equity and cannot successfully be invoked when the result would be fundamentally unjust.

Petitioners have invoked the instrumentality rule in op- sition to the compromise of the Standard claim for an ount representing only legitimate and valid items for purpose of enrichment to themselves at the expense of ndard and its securityholders. The record shows and Circuit Court of Appeals has found that the $5,000,000 mpromise figure of the Standard claim represents only ney advanced to or expended for Deep Rock. Under se circumstances the denial of a claim for such items s the result of enriching the preferred stockholders of ep Rock at the expense of Standard and converts the in-

strumentality rule from a principle of equity into an instrument of punitive oppression. Certainly the invalidity and even the impropriety of other claims asserted by Standard against Deep Rock which are excluded by the compromise can furnish no equitable basis for the denial of valid claims. Much that petitioners have done in their brief is to assail claims which Standard has now relinquished under the compromise. They ask that confirmation of the plan be reversed because Standard did not prove the propriety of items for which it is not recovering under the compromise, such as management fees, rentals, compound interest and dividends.

It should be emphasized that Standard has not taken any assets from Deep Rock which would otherwise be available to pay petitioners. The charges to which petitioners devote so much of their brief were never actually paid. *Standard has advanced in excess of all repayments, over twelve million dollars of cash to Deep Rock* (Vol. I, pp. 61, *et seq.;* Exhibit A, Brief of Standard) *in addition to its original investment as a stockholder, and recovers only a fraction of those sums in the compromise now before this Court.*

Where the record shows cash advanced by Standard to Deep Rock of $31,000,000 and cash received of $19,000,000 (Vol. I, pp. 61, *et seq.;* Exhibit A, Brief of Standard); where it shows that in 1926 Standard took 80,000 shares of preferred stock for a claim of $7,223,000 (Vol. II, pp. 129, 134), and Deep Rock's note for $4,250,000 to liquidate the open account as of December 31, 1926 (Vol. II, pp. 131, 134); and where it shows that in 1928 Standard took, for claims of $11,122,000, common stock, and, for the preferred stock which it received in 1926, more common stock (Vol. II, pp. 68, 114, 129, 273, 274, 426, 701); where, disregarding all bookkeeping, Standard has never actually received in cash anywhere near the amount of cash it has advanced, how

can it be seriously urged that Standard has looted Deep Rock! The "looting" has consisted principally of charges against Deep Rock of items which petitioners feel to be improper. They, however, speak repeatedly of *unlawful withdrawals* of huge sums of money and attribute the business failure to "constant drainage." (Pet. Br. p. 83.)

Indeed, petitioners' position as respects holding companies seems to be that if a parent's claim includes any items which are improper, *valid* items cannot be allowed. (Pet. Br. pp. 48-49.) This inequitable view is in direct conflict with *Southern Pacific* v. *Bogert*, 250 U. S. 483 (1919). There it was held that the owner of 75% of the stock of a railroad could not wrongfully manipulate the reorganization of that railroad in such a way as virtually to exclude minority stockholders; but the decree of the District Court was modified so as to give the majority stockholder the status of a creditor to the extent of its actual advances to the subsidiary in the payment of its creditors. Mr. Justice Brandeis said (p. 496):

> "Some adjustment should obviously be made so as to compensate the Southern Pacific for any contribution made at its expense to the value of the stock in the new company of which the minority stockholders may get the benefit. *The purpose of this proceeding is not to punish the Southern Pacific but to declare and enforce its obligation as trustee. The minority stockholders who seek equity should do equity*; and a court of chancery has power in granting relief to prevent unjust enrichment of the minority stockholders at the expense of the Southern Pacific."

It would be difficult to conceive of a case in which a parent corporation went further in domination of its subsidiary and in defrauding creditors than *McCandless* v. *Furlaud*, 296 U. S. 140 (1935). This Court found that the subsidiary in that case was virtually insolvent from the be-

ginning, and that all the profits received by the promote
were fraudulent and should be returned to the subsidiar
But at the same time it was recognized that the defendan
were entitled to a credit for the expenses validly incurre
in behalf of the subsidiary, even as against its *creditor*
In the words of Mr. Justice Cardozo:

> "There will be a further modification by the allow
> ance to the defendants Furlaud and the Kingsto
> Corporation of so much of the sum of $300,000 [thi
> was the maximum amount claimed by the defendant
> as expenses] as may be found on an accounting to hav
> been disbursed for expenses that are chargeable i
> equity to the Duquesne Corporation, unless the amoun
> of such allowance is fixed by agreement, approved b
> the court to which the receiver is accountable, in whic
> event the judgment against those defendants shall b
> reduced accordingly." (P. 167.)

In the instant case the amount of the compromise ha
already been approved by the trustee and his counsel and b
the District Court.

In *Thomas* v. *Brownville R. R. Co.*, 109 U. S. 522 (1883)
all the directors were clearly guilty of fraudulent conduct
in the negotiation of a construction contract with their cor
poration, and the courts so found. But this Court held that
the wrongdoers were entitled to payment for the construc
tion work actually done and reversed the lower court for
ignoring this principle.

The same principle was applied in the lower courts in the
following cases, without any objection from this Court:

> *Strong* v. *Repide*, 213 U. S. 419 (1909);
> *Wardell* v. *Railroad Company*, 103 U. S. 651 (1880).

Petitioners seek to distort the issue by asserting that the
Deep Rock preferred stockholders were misled in connec-

tion with the sale of such stock. (Pet. Br. pp. 61-64.) In this connection we merely wish to observe that (1) there is no proof in the record dealing with the representations that were made in connection with the sale of Deep Rock preferred stock; and (2) if misrepresentations were made, the vendors (H. M. Byllesby & Co. and the other bankers) are liable, and not Standard or Deep Rock. If petitioners believe that they have a cause of action for misrepresentation in connection with the sale of the preferred stock, we respectfully submit that they should bring suit against the parties alleged to be liable, and not seek to prevent and further delay the reorganization of Deep Rock. There is no evidence that any preferred stockholder of Deep Rock has relied to his detriment upon the published reports of Standard, as suggested by petitioners. (Pet. Br. p. 63.)

Petitioners have included in their brief a charge that a quotation on Deep Rock preferred stock appearing in the Wall Street Journal (Pet. Br. p. 62)was "inspired," and on the basis of that "inference" petitioners charge Byllesby with "market manipulations." There is, of course, no proof to support this inference. The record shows that the trading by Byllesby & Company in Deep Rock securities has only been that which is customary for any banking house. Mr. Shinners' uncontradicted testimony is as follows:

> "In the course of dealing in these securities Byllesby & Company sells to customers. In a trading position they will also buy for their own account occasionally, they will have fifty or seventy-five notes. Every house that maintains active market securities buys securities for their own account from day to day. I don't know that we have owned any of the preferred stock. We might have fifty or seventy-five shares from day to day. Our trade has been rather small in the preferred stock." (Vol. II, pp. 420-421.)

This trading in small amounts is characterized by petitioners as "fraudulent manipulations in the sale and marketing of Deep Rock's securities" (Pet. Br. p. 64), and is asserted as a basic reason why the Standard claim should be denied in its entirety. (Pet. Br. pp. 61-64.) The record does not support the irresponsible and general charges so freely made in this section of petitioners' brief. Petitioners erroneously seek to charge Standard with an alleged wrong by Byllesby, a third person, in order to justify the application of the instrumentality rule.

It is therefore respectfully urged that the so-called instrumentality rule and the body of precedent which gives it expression demonstrate that the District Judge did not abuse his discretion in approving the compromise of the Standard claim. This result seems clear for the foregoing reasons, which may be summarized as follows:

(i) The instrumentality rule depends for its applicability on the facts of each particular case and is a vague and uncertain principle of law devoid of predictability, with the result that counsel for the trustee did not wish "to bet six or seven million dollars that the courts will uphold the instrumentality rule." (Vol. II, p. 563.)

(ii) The theory of the rule is to prevent the conduct of an important part of a parent's business through the use of a subsidiary having grossly inadequate capital which results in loss to creditors who are thereby unable to reach the actual assets of the enterprise. Deep Rock did not transact a part of Standard's business and its capital has always been substantial.

(iii) The rule has never been applied at the behest of preferred stockholders of a subsidiary who did not extend credit to the enterprise but who purchased the securities of the subsidiary itself and dealt with it as a separate entity.

(iv) The rule, if applied to defeat the compromise of the Standard claim, will permit those who ask the relief of equity to share in an unjust enrichment at the expense of the securityholders of the parent.

3. *Additional Factors Which Conclusively Support the Wisdom and Legality of the Compromise.*

(a) The District Judge was patently justified in approving the compromise of the Standard claim for the purpose of avoiding the continued expense and delay incident to further litigation.

One of the primary functions to be served by any compromise is to avoid not only the risks and uncertainties of the final result, but also the extremely heavy burden always attendant upon the delays and expenses of litigation of magnitude. All of the decisions which have reviewed the discretionary acts of a trial judge in approving a compromise comment upon the axiomatic fact that compromises are justified because expense and delay are thereby avoided. In a very recent case, cited above, the Circuit Court of Appeals for the Seventh Circuit commented upon the natural desire of the court to respect the wishes of the parties and avoid a waste of assets in protracted litigation: *In re Van Camp Products Co.*, 95 F. (2d) 206, 209, where Circuit Judge Evans said:

> "However, a sufficient amount is left to necessitate careful study. Such a study was first made by the referee. A similar investigation was also made by a committee who represented a substantial majority of the preferred stockholders. They advised their clients that the claims of the bankrupt against the Milk Company were highly speculative and uncertain, or not provable at all. The action of two-thirds of the preferred stockholders must have influenced both the referee and the court to a certain extent. It should. For, if those who would profit by the allowance and pay-

ment of their claims had no faith in their merit and provability and did not desire the assets now ready for distribution frittered away in fruitless litigation, a court would naturally hesitate before directing the litigation to proceed to the bitter end."

These considerations occupy an important place in the Deep Rock proceeding. The affairs of this oil company have been under the jurisdiction of the District Court since February, 1933. An oil company suffers as much if not more than other enterprises from the necessary limitations on its operations attendant upon the pendency of such court proceedings. The large amount of cash and inventory ($7,039,217.05) held as of October 31, 1936 by the trustee for Deep Rock emphasizes this consideration. (Vol. I, p. 361.) The cash reserves, in effect, represent capital, being the price received for oil taken from the ground and sold by the trustee, with corresponding depletion of oil reserves.[9] No trustee or court officer could proceed as if independent of court control to reinvest this capital in other leases and to expand, develop and seek out new producing properties to replace the old. (Vol. II, p. 490.)

The Standard claim controversy took from February, 1933 to February, 1935—approximately two years—for its presentation by pleadings and for the introduction of evidence before the special master. Because of the size of the claim and the importance of the questions, as the master observed (Vol. I, p. 199), whatever was the result in the District Court, the case would have been carried, if tried on its merits, up through the courts. Litigation of this character and size involves, in addition to the delay, heavy ex-

[9]The trustee has received over $800,000, of which $257,500 has been set aside as a reserve, as the result of tax refunds by the federal government. (Vol. II, p. 747.)

pense as charges against the estate, including the fees of counsel.

We urge that the District Court could not have justified a refusal to approve the compromise and thereby invite years of litigation over the merits of the Standard claim, unless he could predict with confident assurance an ultimate saving to the estate for the benefit of the public noteholders and preferred stockholders of Deep Rock. This, as we have shown, he could not do because of the uncertainties of the situation.

A superficial contention is made by counsel for petitioners who suggest that since they have appealed from the order approving the compromise, and thereby involved the estate in litigation, no useful purpose was served by failing to adjudicate the Standard claim on its merits. (See comment of District Judge—Vol. II, p. 450.)

Petitioners' argument that the approval of the compromise and confirmation of the amended plan did not end litigation nor afford the means of a speedier reorganization seems basically fallacious. The approval by the District Judge of the compromise permitted a speedier reorganization because not only was the claim compromised, but a plan of reorganization was confirmed; and if the District Court orders are here affirmed, the plan can be consummated promptly and the securityholders permitted to participate in the earnings of the properties.

The special master stated (Vol. I, p. 199):

> "Undoubtedly the amounts involved preclude even a hope that this litigation [over the Standard claim] would end in the trial court, if the cause proceed throughout at arm's length, and either claimant or trustee be allowed the full measure of relief to which they respectively assert they would be ultimately entitled. And, conceivably, it could result, that after two

or three years of strenuous litigation, and a trip to th Supreme Court of the United States, the parties woul again be remitted to this forum, with a great mass subsidiary questions remaining still to be finall settled."

Not only would subsidiary questions remain after the fin determination of the litigation over the Standard clai but primary questions would arise, such as the preparatio presentation, acceptance and confirmation of a plan of r organization, followed, possibly, by appeals by the Messr Taylor or some similarly dissatisfied securityholders.

In every case reviewing a compromise *the litigation i volved in the attack on the settlement was not avoided.* Y in these cases the courts invariably refer to the persuasiv circumstances that the compromise did save the expens and delay incident to litigating the controversy which wa settled.

The desirability of effecting compromises for the purpos of avoiding delays and undue expense is even more urgen in proceedings under Section 77B than formerly. This sta ute was designed to promote expedition and econom through the prompt solution of the problems of corporat reorganization by a fair adjustment of conflicting right with the approval of two-thirds of the creditors, a majorit of the stockholders, and the District Court. (See *In re Ch cago, R. I. & P. Ry. Co.*, 72 F. (2d) 443 (C. C. A. 7, 1934) *Continental Bank* v. *Rock Island Railroad*, 294 U. S. 64 (1935); *In the Matter of Utilities Power and Light Corpora tion*, 91 F. (2d) 598 (C. C. A. 7, 1937); *In re McCrory Stores* 14 F. Supp. 739 (D. C. S. D. N. Y., 1935).)

(b) The serious and adverse effects upon the parties in interest which might follow the adjudication of the Standard claim upon the merits clearly justified the trial judge in approving the compromise.

The trial judge, in the determination of whether or not to approve the compromise of the Standard claim, and in connection therewith to confirm the amended plan of reorganization, necessarily faced an appraisal of the interests of the noteholders and preferred stockholders of Deep Rock who would be greatly affected by the final result of a litigation of the claim on the merits. Since Standard accompanied its second offer of compromise with an acceptance of the amended plan of reorganization, the court achieved the following result for the parties in interest in its approval of the compromise and confirmation of the plan: Deep Rock would be reorganized through the creation of a new company, which would obtain title to all its assets and issue only two classes of securities:

(1) $10,000,000 of income debentures, to be distributed dollar for dollar to the present holders of Deep Rock's $10,000,000 of notes;

(2) common stock.

The common stock of the new company would be allocated: 7% to Deep Rock noteholders; 73% to Standard, as a claimant; and 20% to Deep Rock preferred stockholders. *Standard was thereby subordinated to the noteholders.* The reorganized company would acquire, free from any claim of Standard, the properties of the Refining Company, and Standard's claims against Deep Rock would be completely satisfied.

Compared with this result the District Judge faced the following possibility if he declined to approve the compromise and confirm the amended plan:

Standard would of course be free (since the offer of compromise was conditional) to continue in its effort to establish the claim for the full amount of $9,342,000. If Standard demonstrated that the instrumentality rule was not applicable to the claim in question, it is virtually conceded by Standard's principal opponents (the attorneys for the trustee) that Standard might establish a claim on a parity with the noteholders in an amount of $7,604,857.28. (Vol. II, p. 703.) Of course, if Standard established a claim in the neighborhood of $7,000,000 on a parity with the $10,000,000 Deep Rock notes, the plan of reorganization as confirmed by the District Court could never be achieved. It could not be expected that Standard would agree to accept common stock of a new company which would issue $10,000,000 of debentures to the present noteholders.

As stated by Mr. Ramsey, counsel for the trustee, during the confirmation hearing (Vol. II, p. 450):

> "Here is another thought. Suppose there was no compromise; that the trustee had not consented to the compromise. The first compromise was up before the court on the petition of the trustee. Now suppose there is no compromise before the court, and the court should hold that the Standard was entitled to five million, or seven million, which is possible, that claim would be on a parity with the noteholders."

See also Vol. II, pp. 467, 468.

In the light of these circumstances there is no justification for the repeated emphatic assertion by petitioners that the compromise of the Standard claim at $5,000,000 "was beneficial only to Standard" (Pet. Br. p. 16) and that "Standard gained as complete a victory by the compromise as if its claim had been allowed in full." (Pet. Br. pp. 75, 80.) These contentions expose a vital misconception of the actual situation. Since Standard accompanied its

second offer of compromise by an acceptance of the amended plan, the public securityholders of Deep Rock were assured the participation allotted to them by that plan, which participation is obviously far more favorable to their interests than that which could be procured in the event of an allowance of the Standard claim for the full $9,342,000 amount.

Standard's success in the litigation would, therefore, be highly prejudicial to the noteholders of Deep Rock who unquestionably occupy a position senior to that of the preferred stockholders. Petitioners give no recognition to this circumstance; they apparently are not at all concerned with what would happen to the noteholders if Standard were successful in litigating the merits of its claim. The interests of the noteholders, as we have shown, are vitally involved, and their acceptance of the amended plan and its significance cannot be ignored. Of course the reorganization committee, the trustee and the court were concerned with the interests of the noteholders; and necessarily so.

The preferred stockholders *are concerned,* however, as to what would happen *to them* if Standard should succeed in establishing a substantial claim as a result of litigation. It is clear that while the Messrs. Taylor may be willing to gamble their investment on the instrumentality rule, the District Judge did not feel justified in making the wager on behalf of the holders of 60% of the preferred stock who approved the compromise and the amended plan. (Vol. II, p. 573.)

If Standard succeeded in establishing a claim for $7,000,000, or some sum in that neighborhood, that claim plus the debt due the noteholders, with interest, would completely eliminate *any* interest for the preferred stockholders.

It was these considerations which prompted counsel the trustee to say to the court at the hearing on confir tion:

> " . . . I don't believe it is good business to bet or seven million dollars that the courts will uphold instrumentality rule . . . when it comes to my respo bility to the courts and the clients and the partie want to tell you my honest judgment is that is a g compromise" (Vol II, pp. 563-564),

and which caused the District Court to say:

> " . . . I am of the opinion that the court should stand in the way of the execution of the plan, but t the court should use every reasonable means to s guard the future conduct of the company for the mut benefit of stockholders and creditors." (Vol. II, p. 5

(c) Admittedly impartial and well-informed persons h approved the compromise and the reorganizat plan.

We are, of course, entirely content to submit the ord of the lower courts on their merits, and are not asking Court to affirm the exercise by the District Judge of broad discretionary powers solely because the result reac is supported by the great majority of the interested part But it seems particularly significant that the compron has been approved by other persons whose ability and partiality are not open to question:

(1) Preston C. West, an outstanding member of Tulsa Bar (Vol. I, pp. 490, 499; Vol. II, p. 704), was pointed special master by the court, and heard all the te mony on the Standard claim. He recommended its all ance for $5,000,000. While he was not called upon to c sider the second offer of compromise and the desirability its approval in connection with the confirmation of

amended plan, there can be no doubt but that the views expressed by him would necessarily lead to a comparable recommendation on the new offer of compromise which the court subsequently approved. *His scholarly report recommending the original compromise is a convincing and conclusive argument, which we respectfully submit demonstrates the correctness and soundness of the orders of the district judge here subject to review.* (Vol. I, pp. 164-207.) No one has even suggested that he had the slightest motive to favor either side.

(2) Moody's Investors Service and Standard Statistics Company, nationally recognized investment analysts, expressed approval of the plan. (Vol. II, pp. 685, 418-419.)

(3) That H. N. Greis, the independent trustee, and his counsel approve the compromise of the Standard claim at the figure of $5,000,000, is repeatedly shown in the record. The first of the two offers to settle the claim for $5,000,000, filed March 8, 1935, was expressly accepted by the trustee as follows: "H. N. Greis, trustee herein, recommends to the court the acceptance and approval of the above offer of compromise and settlement." (Vol. I, pp. 105, 107.) On March 8, 1935, the trustee filed his petition with the District Judge setting forth the terms of the proposed compromise, and concluded with the recommendation "that he be authorized to compound and settle the controversy with Standard growing out of its claim against Deep Rock and the trustee's objection thereto by accepting Standard's offer in compromise and settlement." (Vol. I, pp. 102-105.)

Following the rejection on September 23, 1935, of the original offer of compromise, which was prompted by the court's disapproval of the original plan of reorganization (see Statement of Facts, p. 20 hereof), the new offer of compromise was filed November 9, 1936, in connection

with an amended plan of reorganization. (Vol. I, pp. 2
298; Vol. II, pp. 731-734.) The new offer of compromi
like the original offer, suggested the allowance of the Sta
ard claim for the same aggregate figure of approximat
$5,000,000. (Vol. II, pp. 446-448.)

When the second offer of compromise and the amend
plan of reorganization were informally presented to t
court, the District Judge requested a committee of thr
members, consisting of Mr. Ramsey, counsel for the trust
Mr. Gibson, counsel for Standard, and Mr. Milsten, Tul
counsel for petitioners, to consider their terms and repo
to the court. Mr. Milsten filed a minority report objecti
to the new compromise and the amended plan, whereas M
Ramsey and Mr. Gibson stated that they were "of t
opinion that it is the best solution of the Deep Rock
present corporate and financial situation, and we therefo
recommend to the court that an order be entered directi
the reorganization committee to obtain from the Standa
Gas and Electric Company, with the approval of the Unit
States Court for the District of Delaware, its, Standard
written offer of compromise of its claim against the De
Rock Oil Corporation," as suggested in the amended pl
and the new offer of compromise. (Vol. I, pp. 248, 247-25

In quoting from the record of the proceedings before t
District Court upon the presentation of the second comp
mise and amended plan (Pet. Br. pp. 78, 92-93), petitione
do not present a complete statement of what actually tra
pired. The record shows that Mr. Greis left to his coun
the question as to whether or not the second proposed co
promise should be recommended by the trustee. (Vol.
p. 523.) No formal recommendation on behalf of the tr
tee was filed either to accept or reject the compromi
(Vol. II, p. 524.) However, Mr. Greis did state that in
opinion the plan was fair (Vol. II, p. 530), and that

Standard paid out money to the other party, they are entitled to it . . . if it is just and so considered, I see no reason why it should not be compromised." (Vol. II, p. 523.)

At the conclusion of the confirmation hearing, following the arguments presented to the court by counsel for petitioners and when the proofs had been closed, Mr. Ramsey stated, on behalf of the trustee, as follows:

"First, *I represent the trustee,* and concur with Mr. Gibson in recommending this settlement to the court. I want to say this much, that I regard that settlement as a good settlement. * * *

"I spent weeks and weeks preparing a brief in this case, with a synopsis and narrative statement of the testimony, got it all right here, every witness's testimony is narrated; every item in this account of the Standard has been investigated. * * *

"Now that [the application of the instrumentality rule] is a debatable question, and the only way the court can find that the Deep Rock is an agency and a department of the Standard is to find they were converted by this operation into a mere instrumentality of the Standard. Now I have argued all those questions. * * *

"So when you get down to this compromise, as Mr. Gibson said, we went over this and this compromise does not allow the Standard any of these items that are contested by the trustee. * * *

"So, taking this whole thing into consideration, I don't think the court will be justified, and after you have added up all the Standard's claims, will run the claim to over $12,000,000, I don't believe it is good business to bet six or seven million dollars that the courts will uphold the instrumentality rule. *Now that is my honest opinion about it. So far as I am personally concerned, I prefer to fight it out, but when it comes to my responsibility to the courts and the clients and*

the parties, I want to tell you my honest judgment is that is a good compromise." (Vol. II, pp. 561-564.)

Nothing could be clearer than that the trustee, officially by his counsel, has expressly recommended the new compromise, although petitioners omit any reference to these statements. We feel that the manner in which the recommendation was made is immaterial and unimportant. The fact is that a highly complicated legal controversy involving complex questions of law and fact was left by Mr. Greis to his counsel with complete authority to act. (Vol. II, p. 523.) Mr. Ramsey was in charge of this litigation for the trustee. The weight which must be placed on Mr. Ramsey's final conclusion is made manifest by a consideration of his relation to the controversy.

The court proceedings were instituted by the filing of a bill for a receiver in the Oklahoma state court on February 28, 1933. The bill was prepared by Mr. Ramsey and his partners and consisted of an attack upon Standard in general and the Standard claim in particular. (Vol. II, pp. 687, *et seq.*) Following the removal of the cause to the Federal Court and the appointment of Mr. Greis and Mr. Moore as co-receivers, Mr. Ramsey was expressly directed and authorized by the court to proceed with the litigation attacking the Standard claim. (Vol. II, pp. 290-292.) This was done by the filing of an answer and counterclaim thereto which reasserted the grounds of objection first alleged in the original bill. (Vol. I, p. 108; Vol. II, p. 276.)

All of the grounds of objection now urged by petitioners are but repetitions of the theories and contentions asserted and made by Mr. Ramsey and his associates. There can be no doubt but that in the final expression of Mr. Ramsey's honest judgment recommending the settlement the court was presented with the prudent view of the best informed

man on the problem—a view reluctantly reached, and a view which emanated from a source naturally colored by a desire to proceed with the litigation. Mr. Ramsey's voluntary expression that the best solution of the situation in the interests of the parties required compromise, not only is entitled to respect because of its significance as to the strength of the position of Standard, but also because Mr. Ramsey expressly preferred his paramount duty to all of the interested parties above his personal desire to sustain the attack he, as an advocate, originated against the Standard claim. (Vol. II, pp. 563-564.)

(4) In addition to those named, more than 82% of the Deep Rock noteholders and more than 58% of the preferred stockholders have approved the compromise and plan. (See *In re Van Camp Products Co.*, 95 F. (2d) 206, 209; cert. den. 59 S. Ct. 65 (1938), quoted p. 81 *supra*.) The proceedings have been marked by the extensive nature of the information submitted to the securityholders, who have acted throughout with the fullest information and as free agents. As shown in the statement of facts, the reorganization committee, upon its organization in 1933, made no attempt to follow the course of procedure frequently adopted —that is, the solicitation of deposits of notes and preferred stock under a "blind" deposit agreement.

It was not until August, 1934, approximately one year and a half after the institution of the receivership and the formation of the committee, that any solicitation was begun. At that time the committee sought the deposit of notes and preferred stock in acceptance of a definite plan of reorganization filed August 9, 1934, under a deposit agreement the terms and provisions of which were found to be fair by the District Judge at a hearing held August 20, 1934, notice of which had been given by publication and mail to each of the securityholders. (Vol. I, pp. 83-88).

The promulgation of this original plan of reorganizatio was accompanied by a disclosure of the business relation ships and connections of each member of the committee, detailed historical statement reviewing the financial an business history of Deep Rock and its accounting practice including in detail a review of the earnings and the charge for depreciation, depletion and amortization. (Vol. I pp. 819-841.)

Notice was given to the securityholders of the hearin before the special master on the first offer of compromis in March, 1935, and of the hearings before the Distric Judge on June 4, 1935 and September 23, 1935, at whic time the question as to whether or not the first offer o compromise should be approved was submitted to the court (Vol. I, pp. 25, 26, 107, 168.) In the period intervening th hearing before the special master and the hearing befor the District Court on September 23, 1935, the objecting pre ferred stockholders, the Messrs. Taylor, the trustee, an the reorganization committee addressed communications t the securityholders. (Vol. II, pp. 698-715.) Thereafter th securityholders were literally bombarded with written argu ment for both sides. (Vol. II, pp. 688-713, 717, 874, 68 682; Vol. I, p. 323.)

The preferred stockholders, in November, 1936, were of fered the opportunity to give a general power-of-attorne to the Taylors, and were urged in unrestrained languag that the protection of their interests required that the give to the Taylors the right to represent them in opposi tion to the compromise and the plan. (Vol. I, p. 323.) N noteholder has excepted to the orders confirming th amended plan and approving the compromise of th Standard claim. The Taylors, for whom the petitione committee was substituted on December 22, 1936 (Vol. I, p 357), have succeeded in procuring a following of approxi

mately 20% of the preferred stock. This group is the sole objector to the compromise of the Standard claim and the confirmation of the amended plan. On February 3, 1937, when the final order was entered, the Taylor committee had procured powers-of-attorney from the holders of 10,295 shares of preferred stock. These include 1,261 shares owned by John M. Taylor, the bulk of which was purchased *after* his original intervention in February of 1935. At that time John M. Taylor owned 250 shares and he and his brother together *owned only 550 shares.* (Vol. I, pp. 33-34, 99-100.)

It is obvious that the Messrs. Taylor, by the purchase of Deep Rock preferred stock at depressed prices, have been speculating in the litigation and at the same time increasing the numerical total of the stock interest represented by the petitioner group. (Vol. II, pp. 584, 557-558, 418.)

The promulgation of the amended plan in November of 1936 was accompanied, pursuant to court order, by a copy of the new offer of compromise. (Vol. II, p. 731.) The reorganization committee then expressly notified every holder of notes and preferred stock who had deposited with the committee in acceptance of the original plan that they could withdraw *without expense* if they did not wish to accept the amended plan or approve the new compromise of the Standard claim. (Vol. II, pp. 728, 729.)

Notices of the hearings on the compromise and amended plan held December 12, 1936 and February 3, 1937, were distributed by mail and also published. (Vol. I, pp. 25, 355.) The actual modifications of the amended plan made by the court order entered December 22, 1936, were distributed to each of the noteholders and preferred stockholders. (Vol. II, pp. 874-877.)

As observed by the District Court, the public owners of Deep Rock securities "do not lack information." (Vol.

II, p. 570.) This large group of widely distributed investors, to the extent of 82% of the noteholders and 58% of the preferred stockholders, with the right on repeated occasions to withdraw without expense, preferred to accept the amended plan and approve the compromise. (Vol. II pp. 579, 872.) *No responsible or truthful contention that the securityholders were not fully advised can be urged or supported.*

Acceptance of the Plan by Holders of More Than a Majority of the Preferred Stock.

Petitioners have suggested (Pet. Br. p. 96) that the amended plan was not accepted in good faith by the holders of the requisite percentage of preferred stock, as stipulated by the statute. Included among the holders of the 30,000 shares (approximately) of preferred stock who have accepted the plan is Utility and Industrial Corporation, an investment trust (hereinafter referred to as U&I), which owns 6,000 shares. It is not contended that U&I does not own these shares or that it did not in fact accept the plan; nor is it contended that U&I purchased its stock to vote in favor of the plan.[10] There is no showing in the record that U&I was influenced in any manner in acceptance of the amended plan by persuasion from Standard. There can be no reason for excluding the vote of the Pitcairns' stock simply because they also own Deep Rock notes.

The same reasons apply in sustaining the right of Standard to vote its shares of Deep Rock preferred stock as a preferred stockholder in acceptance of the amended plan.

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[10]As stated by the District Judge, ". . . If they own these 6,000 shares, and bought it and paid for it, they have the right to deposit it in support of the plan with the committee, just the same as your clients have the right to withhold theirs." (Vol. II, p. 583.)

The committee clearly pointed out in its announcement of both the original and amended plans of reorganization that Standard was the owner of 969 shares of preferred stock and would participate as such preferred stockholder in the securities to be issued by the new company. (Vol. II, pp. 759, 776, 842, 859.) The record shows that Standard bought this stock in 1927 at $89.25 a share. (Vol. II, p. 873.) Even if the shares of U&I and Standard should be deducted from the 29,144 shares accepting the plan, they must also in equity be deducted from the 50,000 shares of which a majority affirmative vote must be procured. This would show that 22,175 shares out of a possible 43,011 shares had approved the plan, being more than a majority.

The mere fact that a stockholder may have an interest in a matter which is being voted on does not deprive him of his vote.

DuPont v. *DuPont,* 256 Fed. 129, 185 (C. C. A. 3, 1919), cert. den., 250 U. S. 642;

Windmuller v. *Standard Distilling Co.,* 115 Fed. 748 (C. C. S. D. N. Y., 1902);

Hodge v. *U. S. Steel Corp.,* 64 N. J. Eq. 807, 54 Atl. 1 (1903);

Gamble v. *Queens County Water Co.,* 123 N. Y. 91, 25 N. E. 201 (1890);

Northwest Trans. Co. v. *Beatty,* L. R. 12 A. C. 589 (1887).

There would be far-reaching and serious consequences of a holding that one who owns securities of more than one class of a corporate debtor cannot vote such securities, and all of them, in favor of a plan without being charged with a bad faith acceptance. As a practical matter, such a decision would virtually prevent the reorganization of corporations of substantial size in the federal courts. For example, a large railroad company, with many different

classes of securities, will almost surely present a situation where individuals or corporations own bonds, debentures, notes and stock of many different classes, all of which will be voted in acceptance of a plan. Whether the individual holder votes his Class A stock in acceptance because of the benefits that the plan will bring to him as a bondholder, or *vice versa,* cannot be made the subject of inquiry. A reorganization could never be achieved if the subjective motive of each individual holder of securities was the subject of inquiry and determination.

As petitioners virtually admit, the sole point which can be made arising from the acceptance of the plan by U&I, the Pitcairns and Standard, is that less weight might be given to their acceptance s than will be accorded the acceptance by the public holders of 20,000 shares of preferred stock who have no such relationship to the creditors of Deep Rock. (Pet. Br. p. 97.)

C. This Court will not review a finding of fact as to the value of the debtor's property lawfully made by the District Judge and affirmed after review by the Circuit Court of Appeals.

The finding of the District Judge as to the value of the debtor's property was a finding of fact. By the terms of the statute (Section 24 (b) of the Bankruptcy Act, 11 U. S. C. A., Sec. 47 (b)), on appeal from a confirmation of a plan the review is limited to issues of law. *Meyer* v. *Kenmore Granville Hotel Company,* 297 U. S. 160 (1936); *In re 620 Church Street Corporation,* 299 U. S. 24, 27 (1936). The finding is binding upon petitioners and cannot here be reviewed. It is based upon and clearly supported by the evidence, including the appraisal by the qualified and independent Trustee (which was confirmed by a thoroughly qualified expert) and by the full record

made of the earnings of the enterprise, and analyses thereof. (Vol. I, pp. 358-361, 401; Vol. II, pp. 526-529, 537, 474-484, 649-650, 738-743, 837-841.)

The attack by petitioners upon the appraisal as prejudiced and partisan (Pet. Br. p. 23) is unsupported by the record and unworthy. The "detailed appraisal" filed by the trustee was "an informed, independent judgment," within the principles announced in *First National Bank* v. *Flershem*, 290 U. S. 504, 525 (1934). The District Court in the *Flershem* case fixed an upset price of $2,500,000, when actual cash (and its equivalent) on hand equalled $2,192,000. (290 U. S. 523.) *The appraisal here was not made by the proponents of the plan of reorganization.*

This case cannot be likened to the inadequacy of proof presented in *National Surety* v. *Coriell*, 289 U. S. 426 (1933). In that case the only officer appointed by the court furnished no inventory of property, no estimate of the value of such property, and no report of earnings from operations. *Every one of these acts has been done in this case by the independent trustee for Deep Rock.* (Vol. I, pp. 28, 358, 359, 396, *et. seq.*; Vol. II, p. 526.) Furthermore, in the *Coriell* case no substantial evidence *of any sort* was presented as to any phase of value. As this Court said at page 435, there were "only informal, inadequate and conflicting *ex parte* assertions *unsupported by testimony.*" Even the number and amount of the claims against the estate were unknown. No such chaos exists in this case. The District Judge was fully informed as to all elements of value. The Circuit Court of Appeals held as follows:

> "The finding of value by the trial court is clearly supported by the evidence. The appraisal was made by the trustee, assisted by the technical staff of the Deep Rock organization, and was approved after a careful check by an independent expert, Mr. Berend.

There was no showing that in making the apprais any pertinent factor was disregarded. Due consider tion was given to going concern value. The cou was entitled to accept and act on such appraisal. *Is Consolidation Coal Company*, D. C. Md., 11 F. Sup 594, 597.

"The sole proof offered by the independent co mittee attacking the appraisal was that of Mr. Smi who frankly admitted he was not qualified to appra the value of the producing properties. His apprais was based solely on capitalization of earnings and an arbitrary allowance for depletion demonstrably i adequate." (96 F. (2d) 693, 707; Vol. I, pp. 498-499

Finding of District Court on Valuation Is Clearly Supported by the Evidence.

The record is replete with evidence which clearly and ad quately supports the finding of the District Judge as t value. The finding as to the value of the Deep Rock pro erties was made by a judge well informed as to the natu of the oil industry in general, and completely familiar wi the particular properties and business problems of Dee Rock as a result of managing the business of the debt through his appointed trustee for four years.

Throughout their brief (Pet. Br. pp. 15, 17, 81) petitio ers misapprehend the basis of the finding of the Distri Judge that the Deep Rock properties do not have a valu in excess of $17,000,000. This finding, while clearly su ported by the appraisal of Mr. Greis (Vol. I, pp. 358-361 is not based solely upon such appraisal, but also upon th other facts appearing of record, including the actual ear ings of the enterprise.[11]

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[11]It is only necessary in passing to state that the book valu carried by Deep Rock for its assets prior to insolvency, such the $37,000,000 figure quoted by petitioners (Br. p. 86A), can no sense be considered evidence to establish actual value.

The Appraisal by the Trustee.

We shall first consider the appraisal and then the record as to earnings. The appraisal of the trustee sets the value of the fixed assets of Deep Rock at $9,508,848.37. (Vol. I, p. 359.)[12] The record clearly shows how this appraisal was made, and that it was the result of competent work conducted by the various department heads and engineers of Deep Rock under the direction and supervision of Mr. Greis himself. The appraisal, as we shall show, was also confirmed as to its fairness and accuracy by the testimony of Mr. O. J. Berend (Vol. II, pp. 477, 484), a highly qualified independent oil appraiser. (Vol. II, pp. 472-474.)

Counsel quote from Mr. Greis' testimony excerpts only, and fail to call attention to the fact that Mr. Greis personally checked the conclusions as to value. He testified as follows: "I went over it and checked the report, and the engineers' report . . . I had a very competent man doing that [valuing the leases]. My geologist has been with me for twelve years, along with our geological department of the Deep Rock." (Vol. II, p. 526.) This evidence shows that the trustee was assisted by his own geologist, who had been with him long prior to his appointment as a receiver or trustee of Deep Rock.

In the formal certificate filed by Mr. Greis it is stated: ". . . and said trustee hereby certifies that said balance sheet and appraisal are true and correct. Dated this 11th day of December, 1936. H. N. Greis, Trustee." (Vol. I, p. 358.)

Where an experienced, independent and disinterested trustee (Vol. II, p. 514) is familiar with and actually

[12]The record below contains an elaborate inventory of the debtor's properties taken as of September 1, 1936, and filed in the reorganization proceedings on December 8, 1936. (Vol. I, p. 358.)

operating the properties of a debtor, it is obviously necessary to employ, at huge expense, some other ex to appraise the property. (Vol. II, pp. 451-453.) The no rule of law that requires, in such circumstances, an a tional outside appraisal of a debtor's properties, and cases cited by petitioners do not so hold. *In re Consol tion Coal Co.*, 11 F. Supp. 594 (D. C. Md. 1935).

The old management had been out of control of Deep R for some years at the time the appraisal was made; an cannot be assumed that all of the department heads employes of Mr. Greis as trustee would have falsified records and fraudulently appraised the property at values because of a supposed allegiance to Standard. Th employes, who assembled the information subject to Greis' check, are shown by the record to have been c petent in appraisal work.

Mr. Berend testified that he checked the methods of p cedure used by the various department heads and e neers who were assigned to the work by Mr. Greis, that he investigated thoroughly their mental attitudes calculations as to "whether they were equipped ment to do this kind of work or whether they were pu operators and had no idea of values." (Vol. II, p. 4 Mr. Berend added: "I entered into this proposition s stantially in the capacity of an executive of an appra organization to serve my assistants to see how they w doing the work, and why they did this, etc., with rela to how it would effect the final results. . . . They did acceptable methods." (Vol. II, p. 484.)

Mr. Berend was personally familiar with much of property of Deep Rock and with the value of properties the locality in which certain of the Deep Rock produc properties were situated. (Vol. II, p. 474.) He had mad

careful check of the trustee's appraisal, visited many of the properties in question and studied carefully the voluminous working papers, engineers' reports and computations used in compiling the final appraisal figures. (Vol. II, p. 474.)

He concluded as to the $9,508,000 valuation fixed by the appraisal for the fixed assets of Deep Rock:

> "My opinion is that it is a reasonable, fair valuation *to a going concern* . . . one that will continue to operate these properties and make the best of them." (Vol. II, p. 477.)

While it would have taken Mr. Berend six months to have done all of the detail work himself he testified that he "reached conclusions satisfactory to myself that I could testify to with a clear conscience." (Vol. II, p. 507.)

Mr. Berend further stated that no attempt had been made to make the appraisal high or low, and that "the men that I talked with seemed to be operating under instructions just to make an appraisal.

"Q. That is to find what the value was?

"A. Yes, sir." (Vol. II, p. 477.)

Trustee's Appraisal Included Going-Concern Value.

The appraisal by Mr. Greis, confirmed by the opinion of Mr. Berend, did not eliminate the item of going concern value. Mr. Berend's testimony (Vol. II, p. 477) has been quoted above. Mr. Greis testified that the net earnings of Deep Rock were taken into account; that "we were making money as a going concern." (Vol. II, p. 529.) He said further (Vol. II, p. 529), ". . . all the units were operating, and as a whole the company was making money, and if continued on a present basis the value as determined for the future as a going concern, based on the earnings that we had made in the past."

While it is true that no arithmetical computation
made from actual earnings in reaching the total f
of the appraisal, the testimony of Mr. Greis shows
the fact that the properties were being operated as a
and were making money as a going concern was a f
which received his most serious attention.

Indeed, the value of the producing properties, show
the appraisal (Vol. I, p. 359) to be in excess of $4,36
actually represents "the future income from those pr
ties." In describing the method by which the produ
properties were evaluated, Mr. Berend testified as foll

> ". . . On the producing oil properties the recove
> oil reserves were estimated, in the case of the older
> settled properties based entirely on past perform
> of the properties; in the case of those properties i
> flush fields that were being produced under prora
> the reserves were estimated according to the
> known methods and practices in the oil busines
> this time. After the reserves were determined
> selling price of the oil was estimated, and dedu
> from that was the cost of production, which was ar
> at by taking their actual experience on these sp
> properties for the year 1935, and also the over
> expenses, which was also taken from their actual e
> rience, and that figure was deducted from the g
> returns. *The net returns were then treated by a*
> *count factor, which would give the per cent valu*
> *the future income from these properties, which*
> *then ascribed as the value of those properties.*" (
> II, p. 475.)

Therefore, *the appraised value of the producing p*
erties actually consists of the future income from t
properties, and not simply their appraisal as such, as
tioners would have the Court believe.

Both Mr. Greis and Mr. Berend testified (and there i
testimony to the contrary) that if the properties

valued as between a willing buyer and a willing seller the value would be *substantially lower than that fixed in the appraisal.* (Vol. II, pp. 477, 505.) Mr. Greis, when examined as to the basis for the appraisal, stated deliberately that the values accepted were chosen with no contemplation of a forced sale but with a consideration of those properties as parts of a going concern. He said:

> "This appraisal was *made on a going concern,* assuming that Deep Rock might reorganize, and these values were put on for *the future performance of the company.* It had nothing to do with a sale." (Vol. II, p. 527.)

The refinery operated by Deep Rock constitutes $1,700,000 of the $9,500,000 appraisal of the fixed assets. That the value of this asset was considered in the light of the debtor as a going concern is clear from the testimony of Mr. Berend, who said, "In this particular territory where this refinery is located there have been five of them shut down, and are being dismantled, or have been to the extent it was found advisable." (Vol. II, p. 500.) If the appraisal had ignored going-concern value as petitioners suggest (Pet. Br. p. 82), it is obvious that the refinery would not have been included at the figure stated.

It is thus absolutely clear from the testimony given at this hearing that, although the trustee did consider the separate items comprising the debtor's properties, as was proper, the final figure found by the trustee as the fair value was his judgment of the fair value of the Deep Rock properties as an entirety on the basis of a going concern—"one that will continue to operate these properties and make the best of them." (Vol. II, p. 477.)

The 1933 Tentative Appraisal.

A strenuous effort is made to discredit the appraisal of Mr. Greis, filed in December, 1936 (Vol. I, p. 359), by show-

ing that during the receivership proceeding in August, the receivers had estimated the fixed assets to have a of around thirteen or fourteen million dollars. Mr. testified that the preliminary appraisal was an estimat the receivers' own information (Vol. II, p. 530); and Francisco testified that the $13,000,000 estimate was early to arrive at some figure and was a "rule of thu appraisal, adding:

> "... in 1935, when we thought perhaps this thing company, might be reorganized, we took an appr of the properties, a detailed appraisal, and then in we duplicated that work." (Vol. II, p. 534.)

> "The estimate of property values made in 1933 1934 by the receivers and trustee, the thirteen mi figure, was not the result of a careful study of the ious units, such as that which is the basis of this praisal here." (Vol. II, p. 537.)

It is perfectly clear that the rule of thumb estimat 1933 cannot be used to contradict the final and formal ion of the trustee made as a result of a detailed and ca study over months of time, and filed of record in Decem 1936.

The testimony of Mr. Greis, relied upon by petitio (Br. p. 85) in reference to a supposed increase in v of the properties during the period of the court adminis tion, must have been caused by confusion, since the de tion of the property in that period greatly exceeded replacements. This is established by the subsequent t mony of Mr. Francisco, which is found on pages 535 536 of Vol. II of the record, as follows:

> "Q. What has happened to the valuation of company since December 31, 1929? A. Oh, m things have happened. The company is seven y older.

Q. Would you say that this company is in better shape today than it was at the inception of the receivership? A. Yes, sir, I should think so. That does not apply to the production properties. I don't say that the production department of this company is not in as good shape today as it was at the time of receivership, but I do say the properties have been depleted; oil has been taken out of the ground, and have not sufficiently been restored in this four years. I don't think it is hard to account for the fact that the average daily production today is about the same as it was at the date of receivership. Stuff under proration would remain maybe fifty years at the same figure if you always had proration.

Q. You know as a matter of fact that there have been a considerable number of new producing wells since the date of receivership, have they not? A. Yes, sir.

Q. And do you think that the value of these new producing wells is greater than the depletion that has taken place? A. No, sir.

Q. Did you hear Mr. Greis' testimony? A. Yes, sir.

Q. Did you understand Mr. Greis to say that those values were greater today? A. I did.

Q. You don't agree with him then? A. No, sir."

It is perfectly obvious that Mr. Greis was not of the secret opinion that the properties had a value in excess of that certified and filed by him on December 12, 1936. Mr. Francisco's statement is a clear explanation that the producing properties had been necessarily depleted and had not increased in value during the receivership. Only $2,500,000 was spent during the years of court proceedings on producing properties, of which $800,000 consisted of the payment of rentals to keep in force undeveloped leases. (Vol. II, p. 520.) When it is remembered that oil has been steadily pumped from the ground ever since March 1, 1933,

and net current assets (consisting largely of cash and
ventory) of approximately $7,000,000 accumulated (Vol
p. 361), it is obvious that the fact that $1,700,000 was sp
in the development of new leases furnishes no basis
determining the actual depletion which the producing pr
erties have suffered. (Vol. II, p. 520.) The extraordin
argument that since receivership, "when Standard was
prived of its opportunity for looting" (Pet. Br. p. 83),
debtor has accumulated large amounts from earnings,
palpably unsound. The current assets, including cash, r
resent the oil which has been taken from the wells.
deductions have been made for amortization, depletion
interest charges. Consequently the cash on hand does n
represent earnings.

The Record as to Earnings.

The court's finding that the assets of Deep Rock do n
have a value in excess of $17,000,000 is not only support
by the appraisal, but also by the record of earnings of t
enterprise, which petitioners insist is the ultimate criteri

Throughout the four-year period, including the equity r
ceivership and the 77B proceeding, the earnings of t
debtor have been reported monthly to the District Cou
(Vol. I, p. 401.) In addition the actual earning history
Deep Rock from 1919 up to the date of the receivership
1933 is presented in the record—broken down year
year—in the form of charts identified as claimants' E
hibits 13 and 14. (Vol. II, pp. 649-651.)

Claimants' Exhibit 14 establishes that for the fourte
years and two months beginning in 1919 and ending
March 1, 1933 (the date of the commencement of th r
ceivership proceeding), the total net earnings of the debto
after deducting charges for depreciation, depletion, amort

zation, etc., were $10,071,739.33. (Vol. II, p. 650.) The average yearly net earnings for the period were thus approximately $710,000. Capitalized at the rate of 10%, the rate advocated by petitioners' sole witness, Mr. C. J. Smith (Vol. II, p. 554), these earnings would indicate a value for all the assets of Deep Rock needed for its business of approximately $7,100,000—a figure substantially lower than the $9,508,000 determined by the trustee in his appraisal for the fixed assets alone.

Petitioners' expert witness, Smith, testified that it would be "fair to set up as the annual depreciation and depletion reserves of the company the aggregate figure of $860,000." (Vol. II, pp. 552-554.) But in their discussion of the declaration of dividends by Deep Rock petitioners assert that there were no profits warranting such dividends, and attach a chart based on federal income tax returns in an attempt to show that Deep Rock "lost money in every year commencing from 1922, with the exception of the years 1925 and 1926." (Pet. Br. pp. 54-56, Chart 2, p. 56A.) The losses shown on those returns are the result of charges for depreciation and depletion claimed by Deep Rock which are substantially in excess of the charges for such items made in the consolidated income statement. (Vol. III, p. 89.) (See footnote 5 *supra*, p. 51, this brief.) Petitioners' attack on the dividends is therefore predicated upon the adoption of the depreciation and depletion figures as claimed in the federal income tax returns, which are, in each instance, from 1919 to 1932 (with the exception of four years) *greatly in excess* of the $860,000 aggregate annual depreciation figure advanced by petitioners' witness Smith. Indeed, the $860,000 annual charge proposed by petitioners is on the whole substantially *lower* than the charges made on the books of Deep Rock (Vol. II, p. 650), upon which the profits were computed which were used as the basis for the declaration of dividends.

The inconsistent positions of petitioners are apparent. In discussing dividend declarations in order to show losses, they adopt the high charges for depletion claimed in the tax returns, and in seeking to prove a high property value they advocate as fair the very much lower $860,000 figure. Of course, counsel sought to prove that $860,000 was a fair depreciation charge in order that he would have a low figure to deduct from net operating earnings during the year 1936, with the result that after deducting from the net operating earnings shown on the trustee's report as of December 31, 1936, the $860,000 depreciation and depletion reserve, there would remain net earnings of $1,360,000, which, when multiplied by ten, would give a value of $13,600,000 for the fixed assets. This valuation counsel describes as "conservative" and as being the valuation "of the only witness who appraised the fixed assets of the debtor in the light of its earnings." (Pet. Br. p. 85.) Only in *one year* (1926) did the net earnings, as shown on Chart 2 (Pet. Br. p. 56A) for the years 1919 to 1932, rise appreciably above the $1,360,000 developed by counsel from the witness Smith. In three "boom" years (1925, 1928 and 1929) the earnings closely approximated that figure. In every other year the net earnings were far below the $1,360,000 figure upon which counsel bases his attack upon the trustee's appraisal.

The actual earnings of the debtor corporation during the period of receivership and trusteeship, from 1933 through November of 1936, are set forth in this record, year by year, in the form of an operating report of the trustee as of November 30, 1936. (Vol. I, p. 401.) The figures therein reported are before charges for depreciation, depletion and amortization.

Mr. Berend characterized the experience during the first ten months of 1936 as favorable, saying, "The oil industry

would be very well satisfied if they could have the same experience over a period of fifty years like they have had in the last ten months." (Vol. II, p. 505.) If we take the actual earnings of Deep Rock, as reported by the trustee for the first eleven months of the year 1936, which was by far the most profitable year that Deep Rock has had during receivership and bankruptcy (Vol. I, p. 401), project that figure for the twelfth month, deduct charges for depreciation, depletion, and amortization in the amounts reported by the reorganization committee to the securityholders and established by uncontradicted testimony (Vol. II, p. 537), and capitalize the net result at the rate of 10%, the net operating earnings for the year 1936 will show a value for the fixed assets, plus operating capital and current inventory, of $7,486,480.20. The actual compilation of these figures is demonstrated by a chart, using the 1936 earnings (attached to this brief as Exhibit A), which demonstrates that the appraisal of the trustee is high.

By capitalizing net earnings, the figure so reached is the value not only of the fixed assets, but also of current inventory, materials and supplies, working capital and good will. The capitalization of earnings reflects the value of *everything* which produced such earnings. *It is therefore striking to observe that the actual net earnings during the year 1936, which is the very best period during receivership and bankruptcy, when capitalized at the rate of 10%* (the figure advocated by petitioners' expert witness Smith) *bring a value for fixed assets, current inventory, material and supplies and working capital of substantially less than the $9,500,000 appraisal made by Mr. Greis to cover physical assets only.*

An examination of Exhibit A to this brief shows that the net earnings were compiled as follows: From the gross earnings as reported by the trustee are subtracted the cost of

sales and operating expenses, general interest, provision for bad debts, and charges for dry holes and abandoned wells all as reported by the trustee. There was also deducted $91,000 per year for amortization of non-productive leaseholds, rentals of non-productive leaseholds as actually paid by the trustee and projected, and a depreciation and depletion charge of $1,200,000. The only figures establishing net earnings of $748,000 per year, which do not appear on the trustee's reports are the deductions for amortization of non-productive leaseholds of $91,000 and the yearly depletion and depreciation estimate of $1,200,000.

Mr. Francisco testified, and his testimony has in no way been contradicted, that the deductions for amortization and depletion as provided in the plan of reorganization were a fair and adequate way to compute such charges in the handling of an oil business. (Vol. II, p. 537.) It is also clear from the record that the $1,200,000 annual depreciation estimated by the committee and reported to the securityholders upon announcement of the amended plan (Vol. II, p. 741) was computed on the basis of a value of fixed assets of $9,500,000. (Vol. II, p. 534.)

Of course the lower the depletion charge the higher the net earnings to be capitalized; also *the lower the depletion charge the lower are the actual values of the properties.* In vouching for the low annual charge of $860,000 (Vol. II, p. 553) petitioners implicitly recognize that the properties do not have a value which warrants a greater reserve. They cannot have both a high value and a low depletion and depreciation charge.

In addition to the reports of income presented to the District Court each month by the trustee (Vol. I, p. 401), this respondent committee introduced in evidence a careful analysis of those figures, including discussions of such im-

portant elements as interest, depletion, amortization of non-productive leaseholds and cost of dry holes. (Committee's Ex. 1, Vol. II, pp. 738-743, 779-785; Committee's Ex. 2, Vol. II, pp. 837-841, 861-865.) This material was, of course, before the court when it fixed the value of the property and approved the plan, and it clearly supports such approval.

Petitioners' Sole Proof Regarding Value.

We turn to the testimony of petitioners' witness Smith, upon which is based the assertion that the finding of the District Judge of value for physical properties should have been $13,600,000 instead of $9,500,000.

In the first place Mr. Smith stated that he didn't "want to qualify [as an expert] on production" (Vol. II, p. 551); that he had not studied any of the reports in reference to the production of any of the production properties; that he does not pretend to know about the value of oil producing properties. (Vol. II, p. 556.) Mr. Smith simply responded to leading questions and deducted from the net operating earnings reported by the trustee $860,000 as the depreciation and depletion reserves. (Vol. II, p. 554.)

It is interesting to observe how this $860,000 is made up: $150,000 a year for the refinery (unexplained); $50,000 a year for the replacement of the pipeline (unexplained); $40,000 for tank cars (unexplained); $500,000 a year for the production properties (based on the amounts spent for production by the trustee *during court proceedings*); and $120,000 for the distributing department (assumed). After these deductions, a figure of $1,360,000 is arrived at, which, when multiplied by ten, would bring a value of $13,600,000 for the fixed assets. As Mr. Smith admitted, what he did was to assume "a certain figure as a net return, and multiply it by ten as a value of fixed assets."

(Vol. II, p. 556.) Of course the whole process is fallacious. A sound depreciation and depletion reserve can only be computed upon the basis of *appraised* values. Values cannot be created by multiplying net earnings reached by deducting an estimated depletion charge.

However, we submit that any record of past earnings is necessarily only one factor in computing future values. This is particularly true in the oil business, where sudden changes in the competitive prices of crude oil and the quantity of production, coupled with both state and national regulation, make any prediction an extremely difficult task even for experts. (Vol. II, pp. 515-516, 478.)

D. Since the District Judge in approving the compromise did not abuse his discretion, and as the finding of value is binding on petitioners and clearly supported by the evidence, the amended plan of reorganization is necessarily fair, and the order of confirmation should be affirmed.

Since the debt owed to the holders of Deep Rock notes plus the compromise figure of the Standard claim exceeded the value of the assets, as found by both the District Judge and Circuit Court of Appeals (96 F. (2d) 693, 707; Vol. I, p. 499), the charge by petitioners (Pet. Br. p. 22) that the $5,000,000 equity of preferred stockholders has been unjustly wiped out is obviously unfounded. *In re 620 Church Street Bldg. Corp.*, 299 U. S. 24 (1936); *In re Barclay Park Corporation*, 90 F. (2d) 595, 596-598 (C. C. A. 2, 1937). Under the plan of reorganization the preferred stockholders of an insolvent corporation are allotted approximately 20% of the equity of the reorganized company, subject only to an issue of debentures aggregating ten million dollars, all of which goes to the public owners of Deep Rock notes. The continued litigation of the Standard claim

on the merits would jeopardize this result and the interest of the public holders of notes and preferred stock.

E. The reorganization committee refers to the record, which completely rebuts the unfair attack upon its personnel and motives.

The general charges of wrongdoing leveled at reorganization committees cannot create issues which do not exist in this case. The same charges have been carefully examined by the District Judge and the Circuit Court of Appeals. Circuit Judge Williams in his concurring opinion flatly stated: "No fraud appears in the record." (96 F. (2d) 693, 707; Vol. I, p. 500.) There is no support in the record for the gratuitous accusations directed against this respondent committee. Throughout, the committee has in no way attempted to influence the court, the receivers, the trustee, or their counsel to cease the attack against the Standard claim. The securityholders have been fully advised of all material facts. (Vol. II, p. 570, and pp. 717-865, esp. pp. 833-835.) Before any solicitations were made the deposit agreement was submitted to the court and approved as fair after full notice and hearing. (Vol. I, pp. 83-88.) All depositors have been given repeated opportunity to withdraw, without expense, from their deposit with the committee if they did not approve the plan or compromise. (Vol. I, pp. 390-392, 429; Vol. II, pp. 728-729.) The second offer of compromise and the amended plan were presented by the reorganization committee in response to the express direction of the District Court. (Vol. I, p. 246.) Obviously such presentation was not an evasion of a decision on the merits of the Standard claim. (Pet. Br. p. 73.)

The reorganization committee was organized under natural and understandable circumstances. (See pp. 11-12 of this brief.) Petitioners have a curious conception of in-

dividual conscience and independence. They apparently b lieve that men of the caliber and standing of Colo Murphy and Messrs. Mason, Holden, Frye and Robe son, because they were asked to serve on a reorganizati committee by Byllesby, would thereafter be dominated a controlled by Byllesby. This, of course, does not follo *There is no evidence* to support the charge of dominati and "employment" (Pet. Br. pp. 88, 89) of the reorganiz tion committee by Byllesby and Standard. (Vol. II, p. 40

Conduct of the Committee.

No one can question the right of the reorganization co mittee to conclude, as it did in the summer of 1933, upon t basis of the facts and the law, that Standard could su port a claim in the amount of approximately $7,300,00 (Vol. II, p. 824.) The important fact is that upon reachin that conclu n the committee in no way attempted to i fluence the court, the receivers, or their counsel to cease t attack against the Standard claim.

Petitioners have attacked as "clearly unwarranted an in bad faith" this conclusion of the reorganization co mittee in reference to the Standard claim. (Pet. Br. p. 91. Since the basic opinion of counsel for the committee that th Standard claim was entitled to recognition has received th support of the District Court and the United States Circu Court of Appeals, we cannot believe that this Court wi seriously accept the charge that it was unwarranted an the result of bad faith.

In refutation of the contention of petitioners that th committee "from the outset" sought the deposit of secur ties (Pet. Br. p. 90), the record shows that the committe waited, without any solicitation, from the spring of 193 until August, 1934, without taking any affirmative step

hopeful that the litigation between Standard and the trustee would soon be determined. (Vol. II, p. 424.) It is perfectly obvious that the committee could be of no assistance to the receivers in the litigation. Every conceivable attack that could be made was being made by counsel for the trustee against the Standard claim. Any work or service performed in this connection by the reorganization committee or its counsel could have been justly criticized as wasteful and officious.

In August, 1934, because of the recent passage of Section 77B, which sought expeditious and economical reorganizations, the committee concluded that it was necessary, in view of the lapse of a year and a half since the commencement of the receivership proceeding, to make some progress toward a reorganization. Accordingly, a plan of reorganization was formulated and a deposit agreement submitted to the court for its approval. On August 20, 1934, the court approved as fair the terms and provisions of the committee's deposit agreement dated as of August 9, 1934, *and authorized the committee to solicit the deposit of Deep Rock notes and preferred stock under said agreement to evidence acceptance by the depositors of the provisions of a plan of reorganization filed August 9, 1934.*

A significant feature of the announcement of the original plan by the reorganization committee is the express statement that it was based upon the committee's conclusion as to the merit of the Standard claim; that the Standard claim was being attacked in its entirety by the trustee for Deep Rock; and that unless Standard could establish a claim for at least $5,000,000, of which a substantial amount would be held to rank on a parity with the notes, the plan could not stand. (Vol. II, p. 824.)

In seeking to bring about a compromise of the claim, the reorganization committee seems to us to have performed a

high duty to the securityholders of Deep Rock. The tru
and his counsel were, of course, free to refuse to com
mise unless it was honestly felt by them that a compro
was justified under the facts established of record.
Ramsey declined to consider compromise until the f
were all of record. (Vol. II, p. 398.) He then negotia
with Mr. Gibson, counsel for Standard, the terms of
original compromise which, as did the compromise fin
approved by the court, eliminated all debatable questi
and reduced the claim from $9,342,000 to $5,000,000.

Counsel for the trustee surely would not have p
mitted the trustee to accept and recommend this c
promise unless he had been convinced that it was to the
interests of the securityholders that the claim be so
justed. In encouraging the compromise and its presen
tion to the court the reorganization committee in all
spects fulfilled its obligations to the securityholders
Deep Rock. *The committee did nothing more than seek
have the parties compose fairly their differences, with
approval of the court.*

Throughout the progress of this long proceeding the
curityholders have at all times been free agents, fully
vised as to their rights, and given an opportunity, unacco
panied by financial burden, to withdraw their acceptan
upon amendments to the plan. Accordingly, every step
the progress of the cause was accompanied by compl
notice and dissemination of information from the comm
tee to the depositors.

The depositors were given the right on the followi
occasions to withdraw from their deposit with the co
mittee if they did not wish to approve the amended pl
and compromise of the Standard claim: first, when t
amended plan and new compromise were filed in Novemb

1936, and the hearing set for December 12, 1936; and second, following the orders of December 22, 1936, modifying the amended plan and setting the matter for final hearing on February 3, 1937. (Vol. II, p. 729; Vol. I, pp. 390-392, 429.)

It is only necessary to refer to the portions of the record which contain the detailed information assembled with care and given to the securityholders, to prove the desire of the reorganization committee that all material facts be disclosed and that the parties actually interested be fully informed. (See Vol. II, pp. 719-757, 819-841.)

We are required to reply, briefly, to the only specific accusations made by petitioners. (Pet. Br. pp. 91-94.)

The Committee's Letter of November 20, 1936.

Petitioners have urged (Pet. Br. pp. 91-93) that a letter addressed by the reorganization committee to the preferred stockholders of Deep Rock under date of November 20, 1936, incorrectly represented the facts. We simply request the Court to read the letter. (Vol. II, pp. 682-684.) The previous letter accompanying the announcement of the amended plan (Vol. II, p. 729) expressly states that "failure to withdraw deposited securities before the date stated [December 5, 1936] will constitute an acceptance and approval of the amended plan and the new proposed compromise of the Standard claim." In the subsequent letter of November 20, 1936, in discussing the efforts of petitioners to induce preferred stockholders "to withdraw their *acceptances*," it was made clear that if sufficient withdrawals were procured the plan could not be presented for confirmation because of insufficient acceptances. (Vol. II, p. 684.) It is astonishing that petitioners assert that the securityholders were not advised by the committee that their failure to

withdraw their securities was an acceptance of the
(Pet. Br. p. 92.)

The letter of November 20, 1936, is also claimed by
tioners to be "absolutely false" (Pet. Br. p. 92) be
the committee there stated that the trustee of Deep
and his counsel had approved the new compromise.
statement was based in part upon the fact that the tr
had formally recommended the original offer of com
mise for $5,000,000 (the second offer of compromise
for the same figure—Vol. I, pp. 102-107; Vol. II, p.

The committee also relied upon the fact that counse
the trustee joined with counsel for Standard in filing
the court a report on the new offer of compromise and
amended plan, in which it was stated:

> ". . . the undersigned have carefully examined
> proposed amended plan and we are of the opinion
> it is the best solution of the Deep Rock's present
> porate and financial situation . . ." (Vol. I, p. 248.)

In any event, counsel for the trustee unequivocally st
in open court his approval of the new offer of compro
upon the conclusion of the confirmation hearing. (Vol.
pp. 561-564.)

The Committee's Consideration of Earnings.

Even the most casual consideration of the detailed ma
rial assembled and analyzed by the reorganization comm
tee for the consideration of the securityholders upon
announcement of the original and amended plans of re
ganization reveals that the committee gave prima
consideration to the earning power of the enterprise. (V
II, pp. 836-841, 738-745.) The essential feature of b
plans involved the issuance of income debentures prov
ing for the payment of interest from available net inco
(Vol. II, pp. 763-769), and particularly careful provisio

were prescribed for the determination of "available net income" and for computing amortization, depletion and depreciation. (Vol. II, pp. 779-785.) The Court will note that the earnings of the property were considered in great detail by the reorganization committee, with an analysis, year by year, of gross earnings and operating expenses coupled with a detailed consideration of depletion and depreciation, amortization, cost of dry holes, property abandonment and rental charges. (Vol. II, pp. 738-743.) Consequently the record shows that the committee's statement to securityholders that it gave primary consideration to earning power in formulating the plans, was obviously true. Petitioners' emphatic accusation that the representation "was a complete falsehood" (Pet. Br. p. 93) is only an irresponsible over-statement.

The Protective Committee Study of the Securities and Exchange Commission.

In a final effort to discredit the reorganization committee, petitioners have departed from the record and called upon the recent report of the investigation of the Securities and Exchange Commission respecting the activities of such committees generally.

Since petitioners have seen fit to depart from the record and seek to influence the Court in this fashion, we are required in justice to the respondent members of the reorganization committee to advise the Court that under date of March 9, 1935, the Securities and Exchange Commission was furnished with complete information in the form of answers to a questionnaire submitted by the Director of the Commission's Protective Committee Study. Later, a representative of the Commission came to Chicago to consult the members of the Committee and their counsel. That representative was given complete information and, under

date of February 4, 1936, was sent a copy of the letter of opinion respecting the validity of the Standard claim addressed on July 14, 1933, to the reorganization committee by its counsel. At no time has the Securities Commission criticized the activities of the reorganization committee or made any charges against the propriety of its conduct.

Whatever may have been the conduct of other committees in other reorganizations in the past, elementary principles of justice require that the reorganization committee of Deep Rock must be judged by the record of this case, and not condemned by the supposed wrongs committed by others. Although the Commission was entirely familiar with the work of the reorganization committee, the material in the Commission's report in no way deals with the instant case. The record here demonstrates the absence of the abuses condemned by the Commission and specifically mentioned by petitioners[13]. (Pet. Br. p. 95.)

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[13]The lists of securityholders were filed with the District Court, and petitioners were permitted by the court to circularize the preferred stockholders. (Vol. I, pp. 217-221, 242, 323; Vol. II, p. 698 *et seq.*)

No promises have been made of commissions to dealers for securing deposits. The committee stated in its communication addressed to securityholders upon announcement of the original plan in August, 1934, that "the committee is advising security dealers that it will make application and recommendation to the court for an allowance to such dealers of 1% of the principal amount of notes deposited at their suggestion." The letter addressed by Byllesby & Company under date of August 25, 1934, stated the same fact. (Vol. II, pp. 835, 682.)

CONCLUSION.

The orders from which the appeal is taken were entered in the exercise of the discretion of the District Judge, and are amply supported by the record. There is no principle of law which suggests or requires their reversal. The compromise of the Standard claim is shown to have been approved in the exercise of a sound and wise discretion. The finding of fact as to the value of the Deep Rock properties should not be disturbed by this Court since the Court will not review a finding of fact and since the finding was lawfully made and is supported by the record, with no competent evidence to the contrary. The plan of organization, in the light of the compromise of the Standard claim and the finding of fact as to the value of the debtor's properties, is fair to the preferred stockholders. The lapse of time, the rights of the parties, the great importance that an oil company's business be freed of the restrictions of direct court administration in a pending 77B proceeding, all combine to support the wisdom of the judgment of the lower courts. We respectfully submit that under the law and on the basis of the record the respondents are entitled to the affirmance of these orders by this Court.

Respectfully submitted,

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EXHIBIT A

DEEP ROCK OIL CORPORATION

OPERATING RESULTS FOR THE CALENDAR YEAR 1936 FROM 11 OPERATING REPORTS OF TRUSTEE FILED OF RECORD, PROJECTE

	Basis of Books of Record								Ot
		Costs and Operating Expenses				Basis of Books of Record			
Year of 1936	Gross Earnings	Cost of Sales	Operating Expenses	Total	Net	General Interest	Dry Holes and Abandoned Well Expense—Based on Charge-off in the Month of November	Provision for Bad Debts	Amort Non-P Leas Basi Avera m $36 and a Life 4
From Monthly Operating Reports:									
January	$ 1,155,118.55	$ 466,036.00	$ 406,476.11	$ 872,512.11	$ 282,606.44			$ 5,000.00	
February	1,028,695.70	595,483.58	336,641.54	932,125.12	96,570.58	$ 42.27		5,000.00	
March	1,131,906.18	583,135.42	369,796.08	952,931.50	178,974.68			5,000.00	
April	1,342,617.39	720,283.83	394,055.07	1,114,338.90	228,278.49			5,000.00	
May	1,393,814.28	721,678.54	409,485.82	1,131,164.36	262,649.92			5,000.00	
June	1,351,236.17	745,966.50	416,879.23	1,162,845.73	188,390.44			5,000.00	
July	1,365,456.96	808,644.13	395,691.73	1,204,335.86	161,121.10			5,000.00	
August	1,384,590.99	780,083.24	410,166.68	1,190,249.92	194,341.07			5,000.00	
September	1,280,245.26	723,770.50	396,985.38	1,120,755.88	159,489.38			5,000.00	
October	1,304,309.94	794,606.88	357,384.67	1,151,991.55	152,318.39	3.78		5,000.00	
November	1,213,127.09	745,826.31	348,158.48	1,093,984.79	119,142.30	429.02	$32,689.51	5,000.00	
	$13,951,118.51	$7,685,514.93	$4,241,720.79	$11,927,235.72	$2,023,882.79	$475.07	$32,689.51	$55,000.00	
One month projected on the basis of 11 months' operation	1,268,283.50	698,683.18	385,610.98	1,084,294.16	183,989.34	43.19	2,971.77	5,000.00	
Estimated for a twelve month period on the basis stated									$9
	$15,219,402.01	$8,384,198.11	$4,627,331.77	$13,011,529.88	$2,207,872.13	$518.26	$35,661.28	$60,000.00	$9

THE OPERATING SECTION, SHOWN ON THE BASIS OF THE BOOKS OF RECORD, DOES NOT
OPERATING RESULTS OF THE DEEP ROCK OIL CORPORATION OF NEBRASKA. DEPLETION AN
CIATION IS SHOWN IN THE AMOUNT SET OUT IN THE "REORGANIZATION PLAN" AND CONSID
PROPERTIES SUBJECT TO DEPLETION AND DEPRECIATION OF THE DEEP ROCK OIL CORPORA
NEBRASKA AND THE DEEP ROCK OIL AND REFINING COMPANY WHICH PROPERTIES, ON THE
APPRAISAL VALUES AT SEPTEMBER 1, 1936, WERE VALUED AS FOLLOWS:

	Appraisal Values As At September 1, 1936		Estimated Annua For Depletion and
Deep Rock Oil and Refining Company:			
Buildings and Equipment	$257,207.99		$70,894.77
Producing Oil and Gas Leaseholds	56,686.44	$313,894.43	3.549.53
Deep Rock Oil Corporation of Nebraska:			
Distributing Stations and Equipment	$192,113.30		$20,896.34
Automobiles and trucks	14,084.00	206,197.30	5,108.99
Totals		$520,091.73	

EXHIBIT A

DEEP ROCK OIL CORPORATION

1936 FROM 11 OPERATING REPORTS OF TRUSTEE FILED OF RECORD, PROJECTED FOR THE 12TH MONTH.

f Books of Record			Other Expenses							
nd Operating Expenses			Basis of Books of Record			Basis as Stated				
Operating Expenses	Total	Net	General Interest	Dry Holes and Abandoned Well Expense—Based on Charge-off in the Month of November	Provision for Bad Debts	Amortization of Non-Productive Leaseholds—Based on an Average Investment of $364,000.00 and an Average Life-Term of 4 Years	Rentals of Non-Productive Leaseholds—Based on Actual Rentals Paid for 7 Months ($42,026.00) Projected for the Period	Depletion and Depreciation. Basis of a Yearly Estimate of $1,200,000.00 Stated in the "Reorganization Plan" and Based Upon Actual Production	Totals	Net Operating Earnings
$ 406,476.11	$ 872,512.11	$ 282,606.44			$ 5,000.00					
336,641.54	932,125.12	96,570.58	$ 42.27		5,000.00					
369,796.08	952,931.50	178,974.68			5,000.00					
394,055.07	1,114,338.90	228,278.49			5,000.00					
409,485.82	1,131,164.36	262,649.92			5,000.00					
416,879.23	1,162,845.73	188,390.44			5,000.00					
395,691.73	1,204,335.86	161,121.10			5,000.00					
410,166.68	1,190,249.92	194,341.07			5,000.00					
396,985.38	1,120,755.88	159,489.38			5,000.00					
357,384.67	1,151,991.55	152,318.39	3.78		5,000.00					
348,158.48	1,093,984.79	119,142.30	429.02	$32,689.51	5,000.00					
$4,241,720.79	$11,927,235.72	$2,023,882.79	$475.07	$32,689.51	$55,000.00					
385,610.98	1,084,294.16	183,989.34	43.19	2,971.77	5,000.00					
						$91,000.00	$72,044.57	$1,200,000.00		
$4,627,331.77	$13,011,529.88	$2,207,872.13	$518.26	$35,661.28	$60,000.00	$91,000.00	$72,044.57	$1,200,000.00	$1,459,224.11	$748,648.02*

:TION, SHOWN ON THE BASIS OF THE BOOKS OF RECORD, DOES NOT INCLUDE
OF THE DEEP ROCK OIL CORPORATION OF NEBRASKA. DEPLETION AND DEPRE-
N THE AMOUNT SET OUT IN THE "REORGANIZATION PLAN" AND CONSIDERS THE
TO DEPLETION AND DEPRECIATION OF THE DEEP ROCK OIL CORPORATION OF
DEEP ROCK OIL AND REFINING COMPANY WHICH PROPERTIES, ON THE BASIS OF
AT SEPTEMBER 1, 1936, WERE VALUED AS FOLLOWS:

	Appraisal Values As At September 1, 1936		Estimated Annual Provision For Depletion and Depreciation	
ing Company:				
ent	$257,207.99		$70,894.77	
s Leaseholds	56,686.44	$313,894.43	3,549.53	$ 74,444.30
n of Nebraska:				
nd Equipment	$192,113.30		$20,896.34	
s	14,084.00	206,197.30	5,108.99	26,005.63
		$520,091.73		$100,449.63

*THE NET OPERATING EARNINGS, WHEN CAPITALIZED AT THE RATE OF 10% (PETITIONERS' RATE OF CAPITALIZATION), ESTABLISH THE VALUE OF $7,486,480.20 FOR A GOING CONCERN.

THE VALUE OF A GOING CONCERN INCLUDES, IN ADDITION TO FIXED ASSETS, CURRENT ASSETS SUCH AS OPERATING CAPITAL AND CURRENT INVENTORY.